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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1946

No. 92

WALTER P. GARDNER, TRUSTEE OF THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, PETITIONER,

vs.

THE STATE OF NEW JERSEY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR CERTIORARI FILED APRIL 20, 1946.

CERTIORARI GRANTED JUNE 10, 1946.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1946

No. 92

WALTER P. GARDNER, TRUSTEE OF THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, PETITIONER,

vs.

THE STATE OF NEW JERSEY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

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IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

No. 8861

In the Matter of the Application of the State of New Jersey for a Writ of Prohibition

No. 8889

In the Matter of The Central Railroad Company of New Jersey, Debtor

State of New Jersey, Appellant

On Appeal from Order No. 271 of the United States District Court for the District of New Jersey. In Proceedings for Reorganization of a Railroad.

Appendix to Petitioner-Appellant's Brief—Filed April 19, 1945

[File endorsement omitted.]

[fol. 1]

In United States District Court, District of New Jersey

Relevant Docket Entries

1939

Oct. 30—Petition for Reorganization under Section 77-A filed 3:00 P. M. at Newark, N. J.

Oct. 30—Order approving Petition as properly filed, continuing debtor in possession, directing filing of schedules and Rule to Show Cause why Trustees should not be appointed, returnable Nov. 27, 1939.

Nov. 9—Proof of Mailing and of Publication directed by Order No. 1 of October 30, 1939.

Nov. 15—Petition for leave to intervene.

Nov. 21—Petition to restrain. (No. 5.)

Nov. 21—Order to Show Cause re restraint. (Order No. 5.)

1939

Nov. 27—Petition of Central Hanover Bank & Trust Company as Trustees etc. for leave to intervene.

Nov. 28—Order appointing Shelton Pitney of New Vernon and Walter P. Gardner of Jersey City, Trustees.

Dec. 7—Petition for Order instructing debtor whether it should pay taxes, etc.

Dec. 7—Order to Show Cause re taxes, etc.

Dec. 11—Order on Petition to intervene.

Dec. 13—Answer of Central Hanover Bank & Trust Co. to petition for instructions.

Dec. 13—Response of Shoenholz, Greenbaum, Wolff & Ernst and Wm. A. Roberts to Order No. 7.

Dec. 13—Affidavit of J. H. Thayer Martin.

Dec. 13—Affidavit in support of Petition for Order No. 7 by Frank M. Snyder, Comptroller of C. R. R.

Dec. 15—Answer and allegations of the State of N. J. by David T. Wilentz, Atty. General to debtor's petition for instructions.

Dec. 15—Affidavit of Owen W. Kite, Deputy Comptroller of N. J.

[fol. 2]

Dec. 15—Affidavit of Raymond M. Greer, City Comptroller of Jersey City, N. J.

Dec. 26—Order No. 11 directing debtor to pay $2,049,553.23 on account of taxes.

Dec. 26—Memorandum on debtor's petition for instructions in regard to payment to the State of New Jersey of taxes for 1939. (Fake.)

1940

Nov. 25—Petition of Trustees for instructions concerning payment of certain taxes and for Order to Show Cause.

Nov. 25—Order to show cause on petition of Trustees, etc.

Dec. 2—Order No. 72 directing Trustees to pay certain amounts on account of New Jersey State taxes, etc.

Dec. 2—Affidavit of Mailing.

Dec. 2—Affidavits on behalf of State of New Jersey.

Dec. 2—Answer of State of New Jersey.

1941

Mar. 26—Reply of claimant, State of New Jersey to Trustee's objection to tax claims.

Nov. 21—Petition of Trustees for order instructing them concerning payments to the State of New Jersey of taxes levied against the debtor and certain of its affiliated companies for the year 1941, Notice and Affidavit of Mailing.

Nov. 24—Order No. 135 instructing the trustees to pay the State of New Jersey, etc.

1942

Feb. 5—Memorandum respecting Jersey City's petition to intervene. (Fake.)

1944

Aug. 14—Petition for adjudication concerning New Jersey State Tax Claims and for order thereon, with Notice of Motion, returnable August 28, 1944.

[fol. 3] Aug. 28—Proof of Service.

Aug. 28—Special appearance of Walter D. Van Riper, Attorney General of New Jersey, etc.

Aug. 28—Hearing on petition for adjudication concerning New Jersey State Tax Claims and for order thereon. (Cal.) Ordered adjourned for three weeks. (Fake.)

Sept. 18—Hearing on petition for adjudication concerning N. J. State Tax Claims and for order thereon. Ordered continued two weeks. (Fake.)

Sept. 2 —Petition of Group of Institutional Investors, Holders of Central Railroad Company of N. J. Securities for leave to intervene with notice of motion thereon returnable October 2, 1944.

Oct. 2—Ordered hearing on petition for adjudication concerning New Jersey State Tax claims continued to October 16, 1944.

Oct. 2—Hearing on petition of Group Institutional Investors, Holders of Central R. R. Co. of N. J. Securities for leave to intervene. No opposition. Order to be signed. (F.)

Oct. 2—Petition of Group of Institutional Investors, Holders of Central R. R. Co. of N. J. Securities for leave to intervene.

Oct. 2—Order No. 249 permitting intervention of Group of Institutional Investors, Holders of Central Railroad Co. of N. J. Securities. (Fake.)

1944

Oct. 16—Ordered hearing on petition for adjudication concerning N. J. State Tax claims referred to Standing Master Augustus C. Studer. (Fake.)

Oct. 16—Order No. 250 re-referring to special master the disputed tax claims of the State of N. J. (Fake.)

Oct. 31—Notice of Appeal from order No. 250 (Copy of notice sent Wm. P. Rowland, Clerk U. S. C. C. A., The Central R. R. Co. of N. J., Shelton Pitney, Walter P. [fol. 4] Gardner, Central Hanover Bank and Trust Co., Institutional Group of Lienors, Brooks Committee of Bond holders).

Nov. 1—Order No. 252 that $250.00 be returned to Treasurer of the State of N. J. and that $250.00 be retained in the registry as a deposit by the State of N. J. for security for costs on appeal from Order No. 250.

Nov. 6—Designation of Contents of Record on Appeal.

Nov. 6—Statement of Points.

Nov. 16—Additional Designation by Trustees of debtor of Contents of Record on Appeal.

Nov. 16—Additional Designation by Institutional Group and the Trustee of the debtor's mortgage of contents of Record on Appeal.

Nov. 20—Affidavit of Mailing, Notice and Petition of trustees for order authorizing them to pay property tax and the franchise tax as finally assessed by the State Tax Commissioner for the year 1944 in accordance with the provisions of the Railway Tax Act, etc.

Nov. 20—Affidavit of mailing, Notice of Petition of trustees for order instructing them to make, on or before December 1, 1944, a further appropriate installment tender under the N. J. Tax Settlement Act.

Nov. 22—Objections of Institutional Group and the Trustee of the Debtor's General Mortgage to claim No. 38 filed by the State of New Jersey.

Nov. 22—Supplemental and Amended Objections and Defenses of Debtor's Trustees to Claims filed by the State of New Jersey.

Nov. 27—Hearing on petition of trustees for order instructing them to make, on or before December 1, 1944, [fol. 5] a further appropriate installment tender under the N. J. Settlement Act—ordered motion granted—Ordered to be signed (Fake).

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Hearing on petition of trustees for order authorizing them to pay the property tax and franchise tax, etc.—ordered motion granted—order to be signed (Fake).

Nov. 27—Order No. 255 authorizing the Trustees to pay the property tax and the Franchise Tax as finally assessed by the State Tax Commissioner for the year 1944 in accordance with the provisions of the Railway Tax Act. Revised Statutes of N. J., 54:29A, and to take all appropriate action to protect the interest of the Debtor's Estate. (Fake.)

Nov. 27—Order No. 256 instructing the Trustees to make, on or before December 1, 1944, a further appropriate installment tender under the N. J. Tax Settlement Act. (Fake.)

Nov. 27—Affidavit of Service of objections of Institutional Group and the Trustee of the Debtor's General Mortgage to Claim No. 38 filed by the State of New Jersey.

Nov. 30—Petition of Trustees for an order authorizing them to pay or tender to the State of N. J. the Principal amount of taxes claimed by the State for the year 1932 and for the year 1933, etc., with affidavit of mailing.

Dec. 4—Ordered—Hearing on petition for an order authorizing Trustees to pay tender to the State of New Jersey the principal amount of taxes claimed by the State of New Jersey for the years 1932 and 1933 adjourned to December 11, 1944. (Fake.) Ordered hearing on petition of Trustees for instructions and authority to enter agreement with [fol. 6] the City of Jersey City with respect to taxes on local properties in said municipality adjourned to January 5, 1945. (Fake.)

Dec. 8—Transcript of Record on appeal sent Wm. P. Rowland, Clerk U. S. C. C. A.

Dec. 9—Notice of Motion and copy of Petition for an order granting the Attorney General of New Jersey leave to join the Trustees of the Debtor in an action to be instituted for a Declaratory Judgment.

Dec. 9—Affidavit of mailing Notice of Motion.

Dec. 11—Affidavit of mailing of supplemental and amended objections and defenses of Debtor's Trustees to claims filed by the State of New Jersey.

Dec. 11—Order No. 258 authorizing the Trustees to pay or tender to the State of New Jersey the principal amount

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of taxes claimed by the State for the years 1932 and 1933, etc.

Dec. 11—Hearing on petition for an order authorizing Trustee to pay or tender to the State of New Jersey the principal amount of taxes claimed by the State for the years 1932 and 1933, etc.—Motion granted—Order signed.

Hearing on Motion for Order granting Attorney General of New Jersey leave to join Trustees in action to be instituted for Declaratory Judgment—Motion denied—Order to be submitted. (Fake.)

Dec. 12—Petition of Attorney General of New Jersey for leave to join Trustees of the Debtor in an action to be instituted for Declaratory Judgment.

Dec. 12—Reply of State of New Jersey to "Supplemental and Amended Objections and Defenses of Debtor's Trustees to claims filed by the State of New Jersey.

[fol. 7] Dec. 14—Affidavit of serving Reply of State of New Jersey to supplemental and amended objections and defenses of Debtor's Trustees to claims filed by State of New Jersey. (William B. Harvey.)

Dec. 14—Affidavit of serving Reply of State of New Jersey to spplemental and amended, etc., by Benjamin C. Van Tine.

Dec. 18—Objections of Watters Committee to Claim No. 38, for $19,849,790.21 for alleged taxes and interest filed on December 10, 1940 by the State of New Jersey.

Dec. 18—Affidavit of Shelton Pitney.

Dec. 18—Hearing Motion by State of New Jersey why a Stay should not be allowed as to the hearing to be had before Standing Master to commence December 19, 1944—Ordered Motion denied. (Fake.)

Dec. 18—Order No. 260 denying petition of Hon. Walter D. Van Riper. (Fake.)

Dec. 18—Notice of Appeal from Order No. 260 (copy of Notice set Wm. P. Rowland, Clerk U. S. C. C. A., The Central R. R. Co. of New Jersey, Central Hanover Bank and Trust Co., Institutional Group of Lienors, Brooks Committee of Bondholders).

Dec. 22—Designation of contents of record on appeal from Order No. 260.

Dec. 22—Affidavit of mailing Designation of Contents of Record on Appeal.

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Dec. 22—Statements of Points.

Dec. 28—Letter designating portions to be sent U. S. C. C. A. for purpose of a Motion for a Stay.

Dec. 29—Affidavit of Service of Objections of Watters Committee.

Dec. 29—Reply of State of New Jersey to "Objections of Institutional Group and the Trustee of Debtor's General [fol. 8] Mortgage to Claim No. 38 filed by the State of New Jersey and affidavit of service.

Dec. 29—Reply of State of New Jersey to "Objections of Watters Committee in Support of Trustees' Opposition to Claim No. 38, etc.," and affidavit of service.

Dec. 30—Affidavit of service of Reply of State of New Jersey to Objections of Watters Committee in support of Trustees' Opposition to Claim No. 38.

Dec. 30—Affidavit of service of Reply of State of New Jersey to Objections of Institutional Group and the Trustee of the Debtor's General Mortgage to Claim No. 38.

Dec. 30—Additional Designation by Institutional Group and the Trustee of the Debtor's Mortgage of Contents of Record on Appeal from Order No. 260.

Dec. 30—Additional Designation by Trustees of Debtor of Contents of Record on Appeal from Order No. 260.

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Jan. 4—Designation by Trustees of Debtor of contents of record on motion to dismiss appeal from Order No. 260.

Jan. 5—Transcript of Record for Preliminary hearing on the Motion for Stay and the Motion to Dismiss Appeal from Order No. 260 sent to W. P. Rowland, U. S. C. C. A.

Jan. 8—Order amending Order No. 252 to provide for the return of the sum of $250.00 to the City of Jersey City, rather than to the Treasurer of the State of New Jersey. (Fake.)

Jan. 8—Order No. 262 providing for inclusion of Group of Institutional Investors, holders of Central Railroad Com- [fol. 9] pany of New Jersey securities, as party appellee in event of appeal by State of New Jersey from Order No. 259. (Fake.)

Jan. 10—Certified copy from U. S. C. C. A. of Order Continuing Stay to February 5, 1945.

Jan. 15—Ordered hearing on Petition of Trustee for in-

structions and authority to enter agreement with the City of Jersey City with respect to taxes on local properties in said municipality adjourned to February 26, 1945. (Fake.)

Jan. 17—Transcript of hearing before Special Master on Order No. 250, November 8, 1944.

Jan. 17—Transcript of hearing before Special Master on Order No. 250, December 19, 1944.

Jan. 17—Interim Report of Special Master.

Jan. 19—Motion of filing report of Special Master.

Jan. 22—Petition and Order No. 266 permitting suit against Trustees. (Fake.)

Jan. 24—Withdrawal of Claim No. 133.

Jan. 24—Transcript of Record on Appeal (Order No. 260) sent Wm. P. Rowland, Clerk U. S. C. C. A.

Jan. 29—Objections of State of New Jersey to Interim Report of Special Master.

Jan. 29—Affidavit of service of copy of "Objections of State of New Jersey to Interim Report of Special Master".

Jan. 30—Notice of Motion for an order adopting and confirming report of Special Master with affidavit of mailing.

Jan. 30—Supplemental Transcript of Record on Appeal from Order No. 260 sent U. S. C. C. A.

Feb. 7—Hearing on Trustees' Motion for an Order adopting and confirming report of Special Master—Ordered Decision Reserved—Briefs to be submitted. (Fake.)

[fol. 10] Feb. 16—$250.00 deposited in lieu of bond for costs on Appeal from Order No. 260.

Feb. 21—Opinion filed, (overruling objections and confirming Master's report). (Fake.)

Feb. 21—Ordered hearing on Petition of Trustees for instructions and authority to enter agreement with City of Jersey City with respect to taxes on local properties in said municipality adjourned to April 9, 1945. (Fake.)

Feb. 26—Petition for and Order No. 270 designating date and prescribing Notice of Hearing on Trustees' Petition for authority to transfer certain properties of the Debtor to a Subsidiary and to take certain other action in connection therewith. (Fake.)

Feb. 28—Notice of application to settle terms of Order No. 271 overruling objections of State of New Jersey to Interim Report of Special Master dated January 17, 1945 and confirming said report.

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Mar. 5—Hearing on application to settle terms of the order overruling objections of the State of New Jersey to Interim Report of Special Master dated January 17, 1945 and confirming said report—Order submitted. (Fake.)

Mar. 5—Order No. 271 overuling objections of State of New Jersey to Interim Report of Special Master dated January 17, 1945 and confirming said report. (Fake.)

Mar. 5—Memorandum on behalf of the Brooks Committee in support of Trustees' petition for order authorizing transfer of certain properties of the Debtor to a subsidiary.

Mar. 5—Affidavit of mailing Notice of Application to settle terms of Order—overruling objections of the State of [fol. 11] New Jersey to Interim Report of Special Master, etc.

Mar. 5—Minutes of Hearing—February 7, 1945.

Mar. 6—Affidavit of mailing Petition of Trustees for order authorizing them to transfer certain properties, etc., and for Order No. 270 designating date of hearing thereon and Order No. 270.

Mar. 6—Order No. 272 continuing hearing on return of Order No. 270 designating date and prescribing Notice of Hearing on Trustees' Petition for authority to transfer certain properties of the Debtor to a subsidiary, and to take certain other action in connection therewith. (Fake.)

Mar. 13—Affidavit of mailing True Copies of "Order No. 272".

Mar. 13—Hearing on Trustees' Petition for authority to transfer certain properties of the Debtor to a subsidiary, and to take certain other action in connection therewith—Adjourned to April 3, 1945. (Fake.)

Mar. 24—Notice advancing date for hearing on Trustees' petition for authority to transfer certain properties of the Debtor to a subsidiary, etc., from April 3, 1945 to March 29, 1945.

Mar. 26—Minutes of Hearing, February 26, 1945.

Mar. 26—Minutes of Hearing, March 5, 1945.

Mar. 29—Affidavit of mailing of Notice advancing date of hearing on Trustees' Petition for authority to transfer certain properties of the Debtor to a subsidiary and to take other action in connection therewith, from April 3, 1945 to March 29, 1945 at 10:30 A. M.

Mar. 29—Hearing on Trustees' Petition for authority to

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transfer certain properties of the Debtor to a subsidiary and [fol. 12] to take certain other action in connection therewith—Decision reserved—Briefs to be filed.

Apr. 2—Affidavit of Mailing, filed.

Apr. 2—Notice of Appeal by the State of New Jersey, filed copies sent to Wm. P. Rowland, Clerk U. S. C. C. A., Central Railroad Company, Shelton Pitney, Walter P. Gardner, Central Hanover Bank and Trust Co., Institutional Group of Lienors, Brooks Committee of Bondholders, Watters Committee of Bondholders.

IN UNITED STATES CIRCUIT COURT OF APPEALS, THIRD CIRCUIT

PETITION

To the Honorable Judges of the United States Circuit Court of Appeals for the Third Circuit:

The petition of the State of New Jersey respectfully shows that:

1. On October 30th, 1939, the Central Railroad Company of New Jersey, a corporation of the State of New Jersey, hereinafter refered to as the Debtor, filed its petition with the District Court of the United States for the District of New Jersey under Section 77 of the Bankruptcy Act. According to the Trustees of the Debtor such action was taken because the State of New Jersey had threatened to enter judgment and sell properties of the Debtor, located within the State, for nonpayment of 1932 and 1933 taxes, litigation concerning which had resulted unfavorably to the Debtor as reported in 100 Fed. (2nd) 139, Certiorari denied 306 U. S. 651, rehearing denied 306 U. S. 669.

[fol. 13] 2. At the time of the filing of the said petition, the Debtor owed balances on its tax debt to the State for the tax years 1932 to 1939 inclusive, all of which balances were liens paramount to all other liens upon all the lands and tangible property and franchises of the Debtor in the State (R. S. 54:27-4), the latest lien having attached for 1939 taxes on June 1st, 1939.

3. The fiscal officers of the State were enjoined by the action of the District Court from proceeding to enforce

any of the tax liens in and to the said lands and tangible property and franchises of the Debtor.

4. When the District Court took custody of the properties of the Debtor upon the filing of the petition, the Court took such custody subject to all of the liens of the State of New Jersey in and to such properties. When the Trustees took title upon their qualification on January 8th, 1940, they took only that interest which is Debtor had just prior to the filing of its petition and which the Court took into its custody on October 30th, 1939.

5. There was on January 8, 1940, no New Jersey statute which gave consent to the Trustees to bring the property rights of the State as represented by its tax liens for the years 1932 to 1939 inclusive, within the jurisdiction of the Bankruptcy Court nor was there any statute authorizing the enforcement of such tax liens in such Court on such date. No such statute has been enacted in the meantime. As of the said January 8th, 1940, the Bankruptcy Court was without authority to make any adjudication concerning the amount and validity of the said tax liens.

6. In 1940 this Court determined adversely to the Debtor litigation involving the 1934, 1935 and 1936 assessments. Judge Maris in an exhaustive opinion reported in 115 [fol. 14] Fed. (2nd) 968 held that the matters had been made *res adjudicata* by the New Jersey Supreme Court in *Central Railroad Co.* v. *Martin*, 114 N. J. L. 69.

7. Thereafter the Comptroller of the State of New Jersey filed with the Bankruptcy Court certain proofs of claims on forms furnished by the Trustees. Such proofs of claim set forth that "the statute of New Jersey provides that these taxes shall be a lien paramount to all other liens upon all the lands, tangible property and franchise of the Company in the State (Section 9, Chapter 208, P. L. 1888, as amended and supplemented; Section 54:27-4 Revised Statutes). The lien shall take effect on June 1 of the year in which the tax is payable."

8. The Trustees now allege that the said filing of the proof of claim by the Comptroller of the State constituted a demand upon the Trustees for payment of the full amount of the tax debt from the estate of the Debtor and that the Trustees are therefore authorized to inquire into the amount

and validity of the State's tax liens. Such a conclusion can only be reached upon the assumption that the estate of the Debtor comprises all of the lands, tangible property and franchises of the Debtor within the State and that it is incumbent upon the State to prove its tax liens before it may share in such estate. The Trustees misconstrue the meaning of the term estate, which is taken into the custody of the Court by the institution of the bankruptcy proceedings.

9. The State of New Jersey urges: (a) Since its tax liens were attached long before the filing of the petition in bankruptcy the estate of the Debtor comprises the properties in the State of New Jersey subject to such liens and before any adjudication may be made concerning such liens, that will be binding on the State, the Bankruptcy Court [fol. 15] must bring into the Court the *res* which is represented by the said tax liens.

(b) To accomplish this result the moving party, the actor, must be the Trustee.

(c) The Trustee in such a case would be compelling the State to engage in litigation, which would in effect amount to a suit against the State which can not be maintained because the State has not consented thereto.

(d) Since the Trustee only had custody of the estate of the Debtor (the equity of the Debtor over and above the State's tax liens), when the Comptroller filed his proof of claim, he could have only intended to make demand upon that portion of the estate upon which the State had no lien.

(e) Since it is fundamental in the law of bankruptcy that one may not make demand against the general or unsecured assets of a Debtor until he has exhausted his security, the Comptroller could at most be deemed to have made demand against the general or unsecured assets for any deficit that might occur upon a sale of the liened properties. Since the said property is apparently worth considerably in excess of the tax debt, it would be the only means of laying the basis for a future possible demand against general assets because the Court had by its restraint made it impossible to prove at this time the adequacy of the security.

(f) If the Comptroller did intend to submit the tax liens of the State to the jurisdiction of the Bankruptcy Court,

the State alleges that he was not authorized to do so either by express provision of statute or by reason of any implied power contained within his broad general powers.

[fol. 16] (g) Notwithstanding the Comptroller did so intend, the State of New Jersey may raise the question of his lack of power at this time (*See Ford Motor Company* v. *Dept. of Treasury of Indiana*, 65 Sup. Ct. Rep. 347 (January 8, 1945)). The State may not be bound by unauthorized action of its officers.

10. Notwithstanding the termination of the 1932 and 1933 litigation by this Court as reported in 100 Fed. (2nd) 139 (cert. den. 306 U. S. 651), and of the 1934, 1935 and 1936 cases as reported in 115 Fed. (2nd) 968, (cert. den. 313 U. S. 568), adversely to Debtor, the said Debtor continued, in company with certain other railroads acting together, to owe large sums of money upon its tax debts for such years. The railroad companies were finally successful in having legislation passed whereby the interest charges, which had accrued because of their defaults, were sought to be forgiven—chapters 290 of the laws of 1941 and 241 of the laws of 1942, hereinafter called the Settlement Acts. The Attorney General of New Jersey conceiving such acts to be unconstitutional filed an information in the Court of Chancery of New Jersey as a result of which the State Treasurer was first temporarily and thereafter permanently enjoined from accepting any payments under the said Settlement Acts, the Court holding that such acts were unconstitutional in *Wilentz* v. *Hendrickson*, 133 N. J. E. 447 (Ct. of Ch. 1943), affirmed by the Court of Errors and Appeals in 135 N. J. Eq. 244.

11. During the course of the last mentioned litigation the Trustees prevailed upon the District Court to make its order No. 163 whereby the obligation of the Debtor to the State of New Jersey was fixed in the amount provided by the Settlement Acts. On appeal to this Court, the said order was set aside. (*In re Central Railroad Co.*, 136 Fed. [fol. 17] (2nd) 633.) Nothwithstanding the clear expression of this Court, the Trustees made no effort to intervene in the New Jersey Chancery proceedings.

12. Shortly after the Court of Errors and Appeals made its determination (135 N. J. Eq. 244), the Trustees filed their petition of August 12, 1944, praying the Bankruptcy

Court among other things to adjudicate "the relative rights, claims, liens and priorities" in the assets of the Debtor's estate.

13. The Attorney General filed a special appearance and moved that the petition be dismissed "insofar as the liens of the State for taxes and interest are sought in any wise to be altered, affected, modified or destroyed."

14. The District Judge refused to pass upon the jurisdictional question but referred the same along with all of the meritorious questions contained in the petition of August 12th to a Special Master for report and recommendation by Order No. 250. The State has appealed from that order and the same is pending. The State in its brief has alleged that the District Court did in fact take jurisdiction. The Trustees in their answering brief have refused to accept the challenge on jurisdiction and have limited their argument to points other than the troublesome problem that it is now sought to have determined. The termination of appeal from Order 250 will in all probability accomplish no more than a modification of the said Order to require the District Court to comply with the accustomed practice that jurisdictional questions be disposed of before proceedings with questions on the merits.

15. Shortly thereafter and long before any attempt was made to consider the jurisdictional matter and notwithstanding the Court's insistence that he had not passed [fol. 18] upon the jurisdictional question, the Court by its Order No. 259, over the objection of the State, provided for the selling of certain liened property, free and clear of the liens, a proceeding which requires jurisdiction of the person of the lien holder. Several other orders were also entered intended to be binding on the State.

16. It then becoming apparent that the Special Master intended to proceed with matters having to do with merits including those involving the Constitutionality of the Settlement Acts insofar as they concerned the Debtor, notwithstanding the views expressed by this Court in *In re Central Railroad Company*, 136 Fed. (2nd) 633, regarding the exercise of a nice discretion, the Attorney General, gave notice that he would move the Court for permission to join the Trustee in a declaratory judgment action to determine whether the Settlement Acts were constitutional

as to the Debtor. The petition of the Attorney General provided "saving in all respects objections heretofore made to the jurisdiction of this Court with respect to the tax debt liens of the State of New Jersey." It was filed on the assumption that the Court had jurisdiction—this being the only way the Attorney General could adequately protect the interests of the State since he had been denied an answer to his jurisdictional objections. Since the Settlement Acts had been tested by means of an information in the name of the Attorney General, it was intended to have a corresponding proceeding as being most likely to achieve the result of having the existing New Jersey Chancery Court injunction lifted in the event the Debtor was succesful. In the course of the several discussions, it was suggested to the Court, that since the constitutional question was being raised, he of his own motion should direct the Trustees to institute an appropriate State Court proceeding if the remedy suggested by the Attorney Gen- [fol. 19] eral was unsatisfactory. Mandamus was suggested as a possibility. Notwithstanding the District Court Judge had the benfit of *Spector Motor Service* v. *McLaughlin*, 99 L. Ed. 105 (U. S. Supreme Court, December 4, 1944), wherein the Supreme Court cited with approval this Court's opinion in *In re Central Railroad*, 136 Fed. (2nd) 633, having to do with this very subject matter and wherein it is reported the Supreme Court of its own motion and without any application being made by any party referred the matter back to the State Court for disposition of matters of local law, the Court by its Order No. 260 denied the application and made no counter proposal, retaining the matter instead in the hands of the Special Master where at present testimony is being taken on matters that are properly those for the State Courts.

17. The State has taken an appeal from order No. 260, although such appeal will be unecessary if it shall be determined that the Bankruptcy Court does not have jurisdiction of the property rights represented by the liens of the State of New Jersey.

18. Thereafter, on December 19th, the Special Master started hearings. It was stated that the jurisdictional question would be considered first. The attorney for the Trustees put in certain matters having to do with certain actions of State officers in connection with the bankruptcy

proceedings; also similar matter in connection with the bankruptcy proceedings of the Erie Railroad Co. and its affiliates and subsidiaries, which occurred in about the same period, similar papers in most cases having been signed by the same Comptroller and Attorney General. When the first witness was put on and asked his first question the State was informed upon inquiry that the jurisdictional case was in and the case on the merits had commenced. Not one single witness was needed to support the [fol. 20] Trustees jurisdictional case which had been referred with all other matters by order No. 250. Less than two hours was consumed in putting in the above mentioned records.

As a result of protest, argument was heard on the jurisdictional question but the State was informed that the Special Master would proceed with the case on the merits upon the following day and before he had determined whether in his opinion the Court had jurisdiction.

19. The State believing that it was entitled to have the matter stayed pending a final determination of the jurisdictional objections and because the Court upon the making of order No. 260 (re constitutionality of Settlement Acts), had refused to grant a stay pending an appeal from said order No. 260, but on the contrary it was the present purpose of the Special Master to proceed with all the meritorious questions including a retrial of the issues of constitutionality having to do with the Settlement Acts, applied for and obtained a temporary stay on December 19th pending application to this Court for a stay pending the termination of the two appeals. Argument was heard on February 5th at which time this Court denied the requested stay.

20. In the meantime, the Master on January 17th, 1945, made an interim report wherein he held that in his opinion the Court had jurisdiction over the matter of the tax claims of the State. He failed to pass specifically upon the allegation of the State that the property rights of the State as represented by its liens upon the land, tangible personal property and franchises of the Debtor are not comprised within the assets of the Debtor now in the custody of the Court and its Trustees. He failed to answer the State's contention that the assets of the Debtor are only that equity which the Debtor had in and to such property and that the

Trustees could not obtain service upon the State or bring [fol. 21] its rights in such property within the jurisdiction because the State had not consented thereto.

21. The State filed objections to the report of the Special Master, calling attention to the fact that the Master had not fairly met the issues presented by the State's denial of jurisdiction in the Bankruptcy Court to make any adjudications that are intended to be binding on the State concerning its liens in and to the properties of the Debtor located in the State of New Jersey. In oral argument before the District Judge on February 7th the State earnestly requested a clear cut determination of this vital issue.

22. Notice was received thereafter that the Special Master would proceed with hearings on the merits, including the constitutional questions, on February 23rd, this notwithstanding the District Judge had made no determination of the jurisdictional objections. On Tuesday, February 20th, this was called to the attention of the Special Master who suggested that the State's representative see the Judge but that it was his intention to go forward.

23. The Deputy Attorney General conferred with Judge Fake that same day; the Judge said that he had not had time to give the matter his consideration. The Judge was informed that the State deemed that it was unseemly that the Master should insist upon proceeding before the Court had made its determination of the jurisdictional question. One day later the Judge informed the State that he had determined that he did have jurisdiction. In a very short finding, he confirmed the Master's interim report, but as in the case of the Master, he assiduously refrained from passing on the specific questions raised by the State (a) that it has a lien interest in the property of the Debtor which was affixed prior to the institution of the Section 77 bankruptcy proceedings, concerning which lien interest no [fol. 22] adjudication could be made by the Bankruptcy Court without the consent of the State and (b) that any attempt to make any such adjudication constituted a suit against the State in violation of its constitutional immunity.

24. The State of New Jersey has not raised the jurisdictional question to harass, hamper or delay. It is the reasoned judgment of the proper officers of the State

government that unless somewhere along the line legal precedents of long standing are upset, the State must finally prevail on its jurisdictional issue. No authorities have been cited by the District Judge in refutation of the State's position concerning its lien interest. The State believes there are no such authorities.

25. If and when the Court has entered its order denying the State's jurisdictional motion, an appeal will be taken from such order, hereinafter designated as Order X. But again although the State may argue that the Court should have found that there is no jurisdiction in the Court to adjudicate concerning its tax liens and although because of the objections of the State and the argument presented, this Court might well dispose of the jurisdictional question on appeal, it is conceivable that so many technical arguments might be advanced so that this Court might well set the said Order X aside and send the matter back for the further action of the District Court. The difficulty that the State has experienced since August 12th, 1944, in getting this very narrow jurisdictional question answered should compel resort to some remedy that will make such course unnecessary.

26. Also, the several matters are in such shape now, through no fault of the State and solely because the District Court had refused to answer the jurisdictional question before trying to go forward on meritorious matters, where [fol. 23] the appeal from Order No. 260 will be heard before the appeal from Order No. X with result that, if the Court should find with the State on its appeal from the said Order No. 260, as it surely must under the doctrine of the *Spector Motor Co.* v. *McLaughlin* case, *supra*, and *In re Central Ry. Co., supra*, and then should find for the State on its jurisdictional question on the appeal from Order No. X, the appeal from Order No. 260 would have become just sheer waste.

27. The only way to put the several matters in some semblance of order is by the use of a writ of prohibition whereby the question of jurisdiction may be more expeditiously disposed of. This remedy was not originally resorted to because of the rule that the writ will ordinarily not issue when there is an adequate remedy by appeal and because the State expected the Court would follow the

usual practice of first disposing of the jurisdictional question. The State has now exhausted its effort to have the jurisdictional question fairly answered so the question may be finally presented to this Court for review. This case is not dissimilar to *Ex parte New York*, 256 U. S. 490, wherein the Court in allowing the writ of prohibition held that an appeal from final judgment was not a sufficiently adequate remedy to warrant the denial of the extraordinary remedy of prohibition to a sovereign state invoking its sovereign immunity from suit.

28. The use of the remedy of prohibition has the additional advantage that if the writ should be allowed, the determination of the jurisdictional question will finally dispose of the matter contained in the appeals from Orders No. 250 and No. X, having to do with jurisdiction, and from Order No 260, which was the result of an application made on the assumption of jurisdiction. If the writ is denied on [fol. 24] the basis that the Court does have jurisdiction, such determination will dispose of the subject matter of the appeal from Orders No. 250 and No. X. It will only be necessary to go forward with the appeal from Order No. 260, concerning the reference of the State constitutional question to the State Courts.

29. The State had been of the opinion that it was entitled to a stay of all proceedings having to do with the amount and validity of its tax liens affixed at the inception of the bankruptcy proceedings, pending the determination of its jurisdictional objections. Had this Court not refused such a stay after lengthy argument, such application would be made at this time in connection with the issuance of a rule to show cause, because the State has believed that it should not be compelled to assume again the tremendous expense of re-litigating matters that this Court on appeal will surely hold have long since been made *res adjudicata*. However, the State defers to the former ruling and will not here request a reconsideration. This observation is made so that the Court may understand the reason why such application is not made.

30. Since, however, the State is being compelled by the District Court to go forward on such questions long since declared by this Court to be *res adjudicata* and since the State is being forced to litigate on matters which this

Court has said should in the exercise of a nice discretion be referred to the State Courts and which this Court on appeal would surely on its own motion refer back for such disposition, and since the State has exhausted every resource at its command to have an early determination whether its property rights are within the jurisdiction of the Bankruptcy Court, the only effective remedy left to the State is this application for a writ of prohibition. Thereby [fol. 25] the State seeks to review the whole question of the power of the Bankruptcy Court to adjudicate concerning the property rights of a State as represented by its tax liens which were affixed prior to the institution of bankruptcy proceedings and thus to assume once more that working arrangement that must obtain if the State government and the federal courts are to function within the same limits as a harmonious whole, that which our highest Court has so often mentioned. On such a review the State asserts that it will prove that the District Court's assumption of jurisdiction constitutes an usurp-tion. If this is done, an expense to which the State is now being put in the preparation of what will be a voluminous, expensive record will be spared.

31. The State calls to the attention of the Court that, the first time that the Trustees sought to have the District Court adjudicate concerning the amount and validity of the State's tax liens, the State interposed its objections. This was done before the Trustees were put to the expense of proving their case. We are not in the position of the Attorney General in *Ford Motor Company* v. *Dept. of Treasury of Indiana*, 65 Sup. Ct. Rep. 347 (January 8, 1945) where the jurisdictional question was raised for the first time in the U. S. Supreme Court, and yet the State's plea to immunity was allowed. It may not be said that we have come at a late date to urge our sovereign immunity.

Wherefore, your petitioner, the State of New Jersey, does pray that a writ of prohibition may issue out of and under the seal of this Honorable Court directed to the District Court of the United States for the District of New Jersey, the Honorable Guy L. Fake, District Judge and the Honorable Augustus C. Studer, Special Master, forbidding and preventing them or any of them from proceeding with the determination of any matters or the making of any

[fol. 26] adjudication in connection with the tax debt liens of the State of New Jersey for the years 1932 to 1939, inclusive, in and upon the lands, tangible personal property, and franchises of the Central Railroad Company of New Jersey, Debtor, presently undergoing reorganization proceedings in the said District Court under Section 77 of the Bankruptcy Act, insofar as it is intended that any such determination or adjudication is intended to be binding upon the State of New Jersey.

And your petitioner will ever pray.

State of New Jersey, By Walter D. Van Riper, Attorney General.

Dated: February 26th, 1945.

STATE OF NEW JERSEY,
County of ——, ss.:

Benjamin C. Van Tine, of full age, being duly sworn according to law, upon his oath deposes and says:

I am Deputy Attorney-General of New Jersey and charged with the handling of all matters connected with the proceedings in the United States District Court for the reorganization of the Central Railroad Company of New Jersey, Debtor under Section 77 of the Bankruptcy Act. I have read the foregoing petition of the State of New Jersey and the matters and things set forth therein are true, except where alleged to be on information and [fol. 27] belief, and as to those matters, they are true to the best of my knowledge, information and belief.

Benjamin C. Van Tine.

Sworn and subscribed to before me, this — day of February, 1945. Alice E. Carroll, Notary Public of New Jersey.

IN UNITED STATES CIRCUIT COURT OF APPEALS

ORDER TO SHOW CAUSE

Present: Biggs, Maris and Goodrich, Circuit Judges.

Upon consideration of the petition of the State of New Jersey by Walter D. Van Riper, Attorney General, filed herein,

A Rule is granted upon Honorable Guy L. Fake, Judge of the District Court of the United States for the District of New Jersey, and the other Judges of the said Court, and upon Augustus C. Studer, Esquire, as Special Master appointed by the said Court, to show cause why a writ of prohibition should not issue as prayed for.

Said Rule being returnable April 2, 1945.

By the Court, John Biggs, Jr., Circuit Judge.

March 9th, 1945.

[fol. 28] IN UNITED STATES CIRCUIT COURT OF APPEALS

ANSWER OF GUY L. FAKE, ONE OF THE JUDGES OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEW JERSEY

I, Guy L. Fake, one of the Judges of the District Court of the United States for the District of New Jersey, in obedience to the order of this Court dated the 9th day of March, 1945, directing me, the other Judges of said Court, and the Special Master, Augustus C. Studer, Jr., to show cause why a writ of prohibition should not issue as prayed for, do hereby certify and make to this Honorable Court the following answer in behalf of myself, the other Judges of said Court, and the Special Master, Augustus C. Studer, Jr.

1. On October 30, 1939 The Central Railroad Company of New Jersey, Debtor, a railroad engaged in interstate commerce, filed in the United States District Court for the District of New Jersey a petition under and by virtue of the provisions of Section 77 of the Bankruptcy Act, 11 U. S. C. A. Sec. 205. On the same day an order approving the petition as filed was signed by me and entered and I have ever since been the Judge of said Court in charge of said reorganization proceedings No. 29,778. The State of New Jersey thereupon appeared before me in said

proceedings, filed proofs of claim for State taxes and at divers times and by divers means has pressed its claims in the proceedings and asserted a preferred and lien position as such tax claimant, as hereinafter more fully set forth.

2. Recently, however, the State of New Jersey has challenged the jurisdiction of the District Court of the United States for the District of New Jersey to pass upon the State's tax claims so filed by it in said proceedings. The single jurisdictional question raised by the State has [fol. 29] been based exclusively on the well recognized principle that a sovereign state may not be sued without its consent.

3. It has therefore seemed that if no suit or action of any kind against the State has in fact been instituted, the State's motion addressed to the jurisdiction of the bankruptcy court to consider the State's tax claims should be overruled.

4. By Order No. 250 entered in the reorganization proceedings on October 16, 1944 I referred said jurisdictional objection or plea of sovereign immunity to the standing Special Master designated and appointed pursuant to said Section 77.

5. On January 17, 1945 the Master filed his report concerning said jurisdictional objection. A copy of said report is annexed to this answer as Exhibit A. The Master reported, *inter alia*, that in his opinion "the claim of the State to sovereign immunity should be denied".

6. The State filed objections to the Master's report and said objections were argued before me on February 7th, 1945. On February 21st, 1945 I filed a memorandum opinion wherein I expressed approval of the Master's report. A copy thereof is annexed to this answer as Exhibit B.

7. On March 5th, 1945 I signed and caused to be entered in the proceedings Order No. 271, to effectuate the conclusions expressed in said memorandum opinion. A copy of Order No. 271 is annexed hereto as Exhibit C.

8. The record in the reorganization proceedings does not disclose that the Trustees of the Debtor or any other

party to said proceedings have instituted any action or [fol. 30] suit of any kind, either *in personam* or *in rem*, against the State of New Jersey.

9. No party to the proceedings has challenged the principle of sovereign immunity or the principle that the custody and title of the Trustees of the Debtor of and to the estate *in custodia legis* is subject to preexisting liens. However, the added and extended concept advanced on behalf of the State has been challenged, viz., the concept that the estate *in custodia legis* consists of "only the interest of the Debtor *over and above*" liens and that "the court has only that equity which the Debtor had immediately prior to the inception of the proceedings". It is that argument or concept which has been rejected by said Order No. 271 and, as well, the assumption that the quantum, rank and extent of security of a lien claim asserted by a state must be accepted and the lien claim allowed exactly as set forth by the State in its proof of claim and without any scrutiny or determination by the Bankruptcy Court of any issues raised with respect thereto by the Trustees and other parties to the reorganization proceedings.

10. An appeal from Order No. 271, if taken, will review and permit disposition of the jurisdictional question decided by me. The State's petition for a writ of prohibition expresses the State's intention to take an appeal from said Order No. 271. It is most respectfully suggested to your Honorable Court that it is here being asked to disregard and by-pass its appellate jurisdiction to review Order No. 271 dated March 5, 1945—which adjudicated that no suit against the sovereign State of New Jersey is involved and accordingly overruled the State's plea of sovereign immunity from suit—and to give original consideration to that same plea under its show cause order of March 9, 1945 why the extraordinary remedy of prohibition should not be granted; and that a writ of pro- [fol. 31] hibition will not be issued except in extraordinary cases or where there is no other remedy available.

11. As hereinbefore indicated, the State of New Jersey has actively participated in the reorganization proceedings from their inception and has zealously asserted and protected its rights as a tax claimant. The State appeared before me by its Attorney General and nominated a pros-

pective trustee at the hearing held on November 27th, 1939 for the purpose of considering the selection of trustees. It also appeared before the Interstate Commerce Commission on the hearing held on December 12th, 1939 to consider the confirmation of the trustees appointed by me. It has also appeared generally and was heard on divers other occasions as, for instance, before the District Court at a hearing held on June 12, 1940, on the Trustees' petition for Order No. 53 authorizing the Trustees to pay monthly installments on account of the taxes assessed against the property of the Debtor for the years 1932 and 1933. At that hearing the Attorney General urged the Court to require the Trustees of the Debtor to pay not less than $1,200,000 on account of the alleged unpaid balance of taxes assessed against the Debtor's property for the years 1932 and 1933. The Court subsequently entered Order No. 53 authorizing the Trustees to pay $150,000.00 per month for six months on account of the taxes assessed for those years. Said payments amounting in the aggregate to $900,000 were made by the Trustees of the Debtor and were accepted by the Treasurer of the State of New Jersey.

12. By Order No. 66 in the reorganization proceedings dated October 7, 1940 I required the claims of all creditors "including all claims of whatever character" against the Debtor "or its property" to be filed by December 31, 1940 in the form and manner prescribed by that Order.

[fol. 32] 13. On December 11, 1940 the State of New Jersey filed its proofs of claim (Nos. 34-38) for alleged 1932-1939 tax balances, in the form prescribed by said Order No. 66.

14. On March 3, 1941 the Trustees filed objections to said proofs of claim.

15. On March 26, 1941 the State of New Jersey filed its "Reply of Claimant, State of New Jersey, to Trustees' Objections to Tax Claims".

16. By Order No. 93 dated April 1, 1941 I referred all disputed claims to the standing Special Master "together with all objections thereto, for hearing and report thereon". Hearings on said claims Nos. 34-38 inclusive had not commenced when on July 22, 1941 Chapter 290 of the Laws of New Jersey of 1941 entitled "An Act relating to the collec-

tion of certain delinquent taxes upon railroad companies" was enacted and became effective. This act was later amended by Chapter 241 of the laws of 1942 (For act as amended see 58 N. J. S. A. Cum. Pocket Supp. Sections A:4—7.1 to 7.16 inclusive.)

17. Litigation ensued which resulted in deferment of consideration of the State's tax claims for approximately three years and until the entry of Order No. 250 dated October 16, 1944 to which reference has hereinbefore been made. See *Wilentz* v. *Hendrickson*, 135 N. J. Eq. 244, affirming 133 N. J. Eq. 447. And see also *In re Central Railroad Company of New Jersey*, 136 F. (2d) 633.

18. The narrow jurisdictional issue has been here set forth as it was presented and argued before me, as of possible convenience to the Court on the return of its order to show cause dated March 9, 1945. I respectfully refrain [fol. 33] from making answer to so much of the petition herein as discusses the merits of the State's tax claims as set forth in its proofs of claim, because the merits have not yet been argued, considered or adjudicated.

19. If it be necessary for respondents to be formally represented by counsel before your Honorable Court, Shelton Pitney, Esq., is hereby appointed as such counsel.

20. On behalf of myself and the other respondents to the order to show cause dated March 9, 1945 I pray that said order may be discharged and that we may henceforth be dismissed.

In witness whereof, I, Guy L. Fake, one of the Judges of the District Court of the United States for the District of New Jersey, have hereunto set my hand and the seal of said Court on this 2d day of April, 1945.

Guy L. Fake, United States District Judge. (Seal of the Court.)

[fol. 34] EXHIBIT "A" TO ANSWER

On Order No. 250 re-referring to Special Master the disputed tax claims of the State of New Jersey, all existing or additional objections thereto and the State's reply to said objections and also referring the State's motion to dismiss the Trustees' petition, dated August 12, 1944, for an adjudication of said claims.

Interim Report of Special Master

To the Honorable the Judges of the District Court of the United States for the District of New Jersey:

Augustus C. Studer, Jr., Special Master, hereby reports to this Court as follows:

By Order No. 250, heretofore made herein under date of October 16, 1944, all tax claims filed by the State of New Jersey, the Trustees' objections thereto and the State's reply to said objections and, also, the purported special appearance of the State of New Jersey objecting to the jurisdiction of this Court, which special appearance was filed herein on August 28, 1944, were referred to the undersigned Special Master for hearing and report thereon.

Pursuant to that order, the matter came on to be heard before the Master on Tuesday, December 19, 1944, in the presence of the following:

Shelton Pitney, Esquire and Walter P. Gardner, Esquire, Trustees of the Debtor;

Benjamin C. Van Tine, Esquire, Deputy Attorney General of the State of New Jersey and Milton B. Conford, Esquire, of Counsel;

Willard P. Scott, Esquire and Blair Reiley, Esquire, for Institutional Bondholders;

[fol. 35] White and Staples, Esquires and Edwin M. Slote, Esquire, of Counsel, by Robert Carey, Esquire and Edwin M. Slote, Esquire, for the Watters Committee; and

Reynier J. Wortendyke, Jr., Esquire, for the Central Hanover Bank and Trust Company, Trustee of the Debtor's Mortgage.

It was agreed by counsel that the question of the Court's jurisdiction to hear and report on the tax claims of the State of New Jersey would be heard first and an interim report filed by the Master on that question. (See Transcript, p. 68.)

This report deals only with the question of the jurisdiction of this Court to hear and determine, without the consent of the State of New Jersey, the tax claims filed by the State of New Jersey herein.

Considered in this report and submitted with it are:

(1) The petition, dated August 12, 1944, of Shelton Pitney and Walter P. Gardner, Trustees of the properties of

the Debtor herein, for adjudication concerning New Jersey State tax claims heretofore filed herein.

(2) Special appearance filed herein under date of August 28, 1944, of Walter D. Van Riper, Attorney General of the State of New Jersey, for the sole purpose of objecting to the jurisdiction of the Court to entertain petition for adjudication concerning New Jersey State tax claims and for Order No. 250;

(3) Proofs of claims Nos. 34, 35, 36, 37 and 38, filed by the State of New Jersey herein;

(4) Objections to proofs of claims Nos. 34, 35, 36, 37 and 38, filed by the Debtor and its Trustees;

(5) Reply of claimant, State of New Jersey, to Trustees' objections to tax claims;

[fol. 36] (6) Supplemental and amended objections and defenses of Debtor's Trustees to the claims filed by the State of New Jersey;

(7) Reply of State of New Jersey to Supplemental and amended objections and defenses of Debtor's Trustees to claims filed by the State of New Jersey;

(8) Objections of Watters Committee, dated December 18, 1944, in support of Trustees' opposition to Claim No. 38 for $19,849,790.21, for alleged taxes and interest, filed on December 10, 1940, by the State of New Jersey in these proceedings;

(9) Reply of State of New Jersey, dated December 29, 1944, to objections of Watters Committee in support of Trustees' opposition to Claim No. 38 for $19,849,790.21, for alleged taxes and interest, filed on December 10, 1940, by the State of New Jersey in these proceedings;

(10) The brief filed herein on behalf of Walter D. Van Riper, Attorney General of New Jersey, appearing specially;

(11) Trustees' brief, filed herein in opposition to motion to dismiss the petition of the Trustees;

(12) Memorandum of Institutional Group and the Trustees of the Debtor's general mortgage in opposition to motion of Walter D. Van Riper, Attorney General of the State

of New Jersey, to dismiss Trustees' petition for adjudication regarding New Jersey State Tax Claims;

(13) Reply of State of New Jersey, dated December 29, 1944, to objections of Institutional Group and the Trustee of the Debtor's general mortgage to Claim No. 38 filed by the State of New Jersey;

(14) The transcripts of the testimony taken at the hearings before the Master on November 8, 1944 and December 19, 1944;

[fol. 37] (15) The exhibits offered at the hearing before the master on December 19, 1944.

The Trustees of the Debtor filed objections and supplemental and amended objections and defenses to the claims filed by the State of New Jersey herein and also filed their petition for adjudication concerning the New Jersey State tax claims hereinabove referred to, in which, among other things, they prayed (Petition, p. 24) that this Court adjudicate "to what extent, if at all, the proofs of claim of the State of New Jersey should be allowed". Other prayers are contained in that petition, but the prayer last above quoted is the only one substantially involved in this report, because at the hearing before the Master the question was presented and argued by counsel on that basis.

The State of New Jersey, by its Attorney General, specially appearing, contends that it was not the intention of Congress, by Section 77 of the Bankruptcy Act, to confer upon this Court power "to make an adjudication that will be binding upon the sovereign State of New Jersey concerning the amount of the tax debt that is due and payable to the State, which is a paramount lien upon the properties of the Debtor within its boundaries, or an adjudication in anywise concerning or affecting such liens" (Brief, p. 1); also, that if the act be so construed, it is unconstitutional, as violating the State's sovereign immunity from suit under the Eleventh Amendment to the Constitution (Brief, p. 16); also, that Section 64 (a) of the Bankruptcy Act does not confer such power upon this Court in this proceeding, because the claims of the State herein are secured by liens (Brief, p. 20).

The constitutional immunity of the State of New Jersey from a suit in a Federal Court, without its consent, is admitted as a general proposition.

On behalf of the State, both in the brief filed by the Attorney General and in the argument made at the hearing, [fol. 38] it was vigorously contended that the Comptroller of the State of New Jersey, in verifying the proofs of claims in these proceedings, which were filed in the name of the State of New Jersey as claimant, by so doing, did not and could not waive any immunity from suit which the State of New Jersey had.

The Trustees maintain that they are defending the debtor's estate against the State's claims; that the State is the claimant and actor; that here is a fund in Court—an estate *in custodia legis*—in which the State claims an interest and against which it asserts its claims (Trustees' brief, p. 2). They maintain further that they resist, but seek no recovery from the State and assert no right, title or interest in and to any property of the State; they say their petition herein reveals certain of their defenses to the State's proofs of claim, including defenses which have arisen since their original objections were filed and that it supplements the defenses stated in those objections (Trustees' brief, p. 2).

From the testimony taken at the hearing before the Master and the exhibits then marked in evidence, the Master makes the following findings of fact:

(1) The State's proofs of claim in these proceedings, numbered 34, 35, 36, 37 and 38, were filed in the name of the State of New Jersey as Claimant. They were signed and verified by Frank J. Murray, "Comptroller of the Treasury of New Jersey". They designated David T. Wilentz, Attorney General, State House, Trenton, New Jersey, as "Attorney Authorized to Represent Claimant" and on their backs the following appears: "Claim of State of New Jersey, David T. Wilentz, Attorney for Claimant, Address: State House, Trenton, N. J." In the body of each of those claims, Paragraph (4) says:

> "(4) Security or lien, if any, for said claim: Answered in (10) below:

[fol. 39] Also, in the body of each of those claims, Paragraph 10 says:

> "(10) Lien, priority or preferential classification, if any, claimed for the claim, or any part thereof,

the reasons therefor and full statement of the facts respecting same:

"The statute of New Jersey provides that these taxes shall be a lien paramount to all other liens upon all the lands and tangible property and franchises of the company in this State (Section 9, Chapter 208, P. L. 1888, as amended and supplemented; Section 54:27-4, Revised Statutes). The lien shall take effect on June 1 of the year in which the tax is payable."

(2) The Trustees filed objections in the proceedings to proofs of claim Nos. 34, 35, 36, 37 and 38.

(3) The State of New Jersey filed in these proceedings Reply of Claimant, State of New Jersey, to Trustees, objections to tax claims (Nos. 34, 35, 36, 37 and 38). That reply was signed "David T. Wilentz, Attorney General, Attorney for Claimant, State of New Jersey, State House, Trenton, New Jersey;"

(4) A petition was filed by the State of New Jersey in the Erie Railroad reorganization proceedings then pending in the District Court of the United States for the Northern District of Ohio, Eastern Division, for leave to file its claim against the Trustees for the unpaid balance of taxes and assessments for the years 1939 and 1940, inclusive. That petition was signed "David T. Wilentz, Attorney General, State House Trenton, New Jersey, Spieth, Taggert, Spring & Annat, By Paul H. Keough, of Counsel, 1568 Union Commerce Building, Cleveland, Ohio. Attorneys for Claimant, State of New Jersey" (Exhibit T-8, December 19, 1944):

[fol. 40] (5) Order No. 404, filed February 28, 1942, was made by R. N. Wilkin, District Judge, in the said reorganization proceedings of the Erie Railroad authorizing the State of New Jersey to file its claim for 1939 and 1940 taxes (Exhibit T-9, December 19, 1944);

(6) In the said reorganization proceedings of the Erie Railroad Company a proof of claim was filed in which the State of New Jersey was the claimant. That claim was signed and verified by Frank J. Murray, "Comptroller of the Treasury" and it designated David T. Wilentz, Attorney General, State House, Trenton, New Jersey, as "Attor-

ney Authorized to Represent Claimant". In the body of the claim, Paragraph (4) says:

> "(4) Security or lien, if any, for said claim: Statutory paramount lien on property for 1933 to 1937, inclusive, taxes; such lien on 1938 taxes attaches on November 1, 1938."

Also, in the body of the claim, Paragraph (10) says:

> "(10) Priority or preferential classification, if any, claimed for the claim, or any part thereof, the reasons therefor and full statement of the facts respecting same: Established by statute as a lien paramount to all other liens upon the lands, tangible property and franchises of Debtor from and after November 1, of the year for which the taxes for each year are assessed, respectively."

(Exhibit T-10, December 19, 1944);

(7) An answer to proof of claim No. D-17 of the State of New Jersey was filed by the Trustees of the property of Erie Railroad Company in the said reorganization proceedings of that company (Exhibit T-11, December 19, 1944);

[fol. 41] (8) A reply was filed in the said Erie reorganization proceedings to the answer and objections of the Trustees to the proof of claim filed therein by the State of New Jersey for unpaid taxes levied by the State of New Jersey upon the property and franchise of Erie Railroad Company, Debtor. That reply was signed "David T. Wilentz, Attorney General, Attorney for Claimant, State of New Jersey, State House, Trenton, New Jersey" (Exhibit T-12, December 19, 1944);

(9) A supplemental answer to proof of claim No. D-17 of State of New Jersey was filed by the Trustees of the property of the Erie Railroad Company in the said Erie reorganization proceedings (Exhibit T-13, December 19, 1944);

(10) A reply to the supplemental answer filed by the Trustees in the said Erie reorganization proceedings to proof of claim No D-17 of the State of New Jersey, and theretofore filed therein, was also filed in the said Erie re-

organization proceedings. That reply was signed "David T. Wilentz, Attorney General of the State of New Jersey and Spieth, Taggert, Spring & Annat, by Paul H. Keough, of Counsel, 1568 Union Commerce Building, Cleveland, Ohio. Attorneys for Claimant, State of New Jersey" (Exhibit T-14, December 19, 1944);

(11) A proof of claim for taxes for the years 1939 and 1940 against Erie Railroad Company, Debtor, was filed in the said reorganization proceedings of that company. That claim was signed:

"State of New Jersey
Name of Claimant
"By Homer C. Zink
"Comptroller of the Treasury."

[fol. 42] It was verified by Homer C. Zink, who swore that he was "the Comptroller of the Treasury of claimant herein." In the body of the claim Paragraph (4) says:

"(4) Security or lien, if any, for said claim: The state of New Jersey has a statutory paramount lien on the property of this debtor as to the 1939 tax. This lien took effect June 1, 1939, and as to the 1940 tax, this lien took effect on June 1, 1940."

Also, in the body of the claim Paragraph (8) says:

"(8) Priority or preferential classification, if any, claimed for the claim, or any part thereof, the reasons therefor and full statement of the facts respecting same: Claim for these taxes is by statute a lien paramount to all other liens upon the lands, tangible property and franchises of debtor, from and after June 1 of the years 1939 and 1940, respectively."

(Exhibit T-15, December 19, 1944);

(12) Answers to proof of claim supplemental D-17 of State of New Jersey were filed in the said Erie reorganization proceedings by H. A. Taylor, Vice-President and General Counsel and Robert E. Woodruff and John A. Haddon, Trustees of the Property of Erie Railroad Company, by H. A. Taylor, Counsel for Trustees, respectively (Exhibits T-16 and T-17, December 19, 1944);

(13) A reply was filed by the State of New Jersey as claimant in the said Erie reorganization proceedings to the answer of Erie Railroad Company to proof of claim supplemental No. D-17. This reply was signed "David T. Wilentz, Attorney General of the State of New Jersey and Spieth, Taggert, Spring & Annat, By Paul H. Keough, Attorneys for Claimant, State of New Jersey" (Exhibit T-18, December 19, 1944);

[fol. 43] (14) A further reply to the answer of the Trustees to proof of claim supplemental No. D-17 was filed in the said Erie reorganization proceedings by the State of New Jersey. It was signed "David T. Wilentz, Attorney General of the State of New Jersey and Spieth, Taggert, Spring & Annat, By Paul H. Keough, Attorneys for Claimant, State of New Jersey" (Exhibit T-19, December 19, 1944);

(15) A second supplemental answer to proof of claim No. D-17 of State of New Jersey was filed by the Trustees in the said Erie reorganization proceedings (Exhibit T-20, December 19, 1944);

(16) A reply was filed by the State of New Jersey in the said Erie reorganization proceedings to the second supplemental answer filed herein by the Trustees and signed "David T. Wilentz, Attorney General of the State of New Jersey and Spieth, Taggert, Spring & Annat, By Paul H. Keough, Attorneys for Claimant, State of New Jersey" (Exhibit T-21, December 19, 1944);

(17) An amendment was filed by the State of New Jersey as claimant in the said Erie reorganization proceedings to the reply theretofore filed therein to the Trustees' answer. This amended reply was signed "David T. Wilentz, Attorney General, Attorney for Claimant, State of New Jersey, State House, Trenton, New Jersey" (Exhibit T-22, December 19, 1944);

(18) In the reorganization proceedings in this Court of Northern Railroad Company of New Jersey, Debtor, which were also brought under Section 77, David T. Wilentz, as Attorney General of New Jersey, gave notice under date of October 18, 1939, to Northern Railroad Company of New Jersey and its Trustees that on November 2, 1939, he would apply to Thomas W. Trenchard, one of the Justices of the Supreme Court of the State of New Jersey, for an order

[fol. 44] that the unpaid part of the tax levied by the State Tax Commissioner against the Northern Railroad Company of New Jersey for the year 1933, pursuant to statutes referred to in that notice, be made a matter of record of that Court and judgment entered thereon. That notice is attached to and made a part of Exhibit W-2, December 19, 1944;

(19) Based upon the petition of the Trustees of Northern Railroad Company of New Jersey (Exhibit W-2, December 19, 1944) this Court made an order dated November 1, 1939, enjoining David T. Wilentz, Attorney General of the State of New Jersey, from taking any proceedings under or pursuant to the notice (last above referred to) theretofore served upon those Trustees by the said David T. Wilentz, Attorney General (Exhibit W-3, December 19, 1944);

(20) In the same proceedings the Attorney General of the State of New Jersey advised the Trustees of the Northern Railroad Company of New Jersey that he had no objection to the allowance of the injunction prayed for by them (Exhibit W-6, December 19, 1944) and the restraint against him was continued (Exhibit W-7, December 19, 1944);

(21) In the reorganization proceedings in this Court of the Susquehanna Railroad Company, a proof of claim was filed against the railroad for taxes due the State of New Jersey. In filing that proof of claim in those proceedings, the same course was pursued which was pursued in filing the claims in these proceedings and the claims there filed were in the same form and tenor as the proofs of claims filed in these proceedings. (See stipulation between counsel, Testimony, pp. 63 to 64.)

With reference to the general duties of the State Comptroller, *N. J. R. S. 54:19-10*, provides:

"The state comptroller shall:

"a. Superintend the collection of the revenue;

[fol. 45] "b. Take general charge and supervision of all rights, interest and property of the state;

"c. Institute and direct prosecution against delinquent officers of the revenue, and for just claims and debts due to the state;"

With reference to the general duties of the Attorney General of the State of New Jersey, *N. J. R. S. 52:17-2*, provides:

> "The attorney general shall, when not incompatible with his other public duties:
>
> • • •
>
> "g. Attend generally to all matters in which the state is a party or in which its rights and interests are involved;"

Based upon the course of conduct of the Comptroller and of the Attorney General in the other reorganization proceedings above mentioned, namely, the Erie Railroad Company, the Susquehanna Railroad Company and the Northern Railroad Company of New Jersey, and considering the statutes last above quoted with reference to the duties of those officers, it is the opinion of the Master that in connection with the filing of the claims of the State of New Jersey in these proceedings the Comptroller and the Attorney General acted in pursuance of their statutory duties and that the proofs of claims of the State of New Jersey filed in these proceedings were properly filed.

Section 77 of the Bankruptcy Act (c) provides:

> "(7) The Judge shall promptly determine and fix a reasonable time within which the claims of creditors may be filed or evidenced and after which no claim not so filed or evidenced may participate except on order for cause shown, the manner in which such claims [fol. 46] may be filed or evidenced and allowed, and for the purposes of the plan, and its acceptance, after notice and hearing, the division of creditors and stockholders into classes according to the nature of their respective claims and interests," etc.

Sub-section (c) of the same Act also provides:

> "(13) The judge may on his own motion • • • refer any matters for consideration and report, either generally or upon specified issues, to one of several special masters who shall have been previously designated to act as special masters in any proceedings under this section by order of any circuit court of appeals," etc.

The same Act, in discussing a plan of reorganization in sub-section (b), provides, among other things, for "the sale of all or any part of the property of the debtor either subject to or free from any lien at not less than a fair upset price, the distribution of all or any assets, or the proceeds derived from the sale thereof, among those having an interest therein, the satisfaction or modification of any liens," etc.

Sub-section (b), Paragraph (5) of the same Act provides:

> "The term 'creditors' shall include, for all purposes of this section all holders of claims of whatever character against the debtor or its property," etc.

The same sub-section (b), Paragraph (5), also provides:

> "The term 'claims' includes debts, whether liquidated or unliquidated, securities (other than stock and option warrants to subscribe to stock), liens, or other interests of whatever character."

[fol. 47] Sub-section (a) of the same Act provides that the Court "shall, during the pendency of the proceedings under this section and for the purposes thereof, have exclusive jurisdiction of the debtor and its property whenever located, and shall have and may exercise in addition to the powers conferred by this section all the powers, not inconsistent with this section, which a Federal court would have had if it had appointed a receiver in equity of the property of the debtor for any purpose."

Sub-section (1) of the same Act provides:

> "(1) In proceedings under this section and consistent with the provisions thereof, the jurisdiction and powers of the court, the duties of the debtor and the rights and liabilities of creditors, and of all persons with respect to the debtor and its property, shall be the same as if a voluntary petition for adjudication had been filed and a decree of adjudication had been entered on the day when the debtor's petition was filed."

In the opinion of the Master, the foregoing provisions confer upon this Court jurisdiction over the kinds of claims asserted by the State in this proceeding and such construction of the Act is not unconstitutional as against the State,

but is within the power conferred upon the Congress by the Federal Constitution to establish uniform laws on the subject of bankruptcies *Van Huffel* v. *Harkelrode*, 284 U. S., p. 225; *New York* v. *Irving Trust Company, Trustee in Bankruptcy*, 288 U. S., p. 329.

The fact is, and the Attorney General of the State of New Jersey so asserts, that the State of New Jersey has claims for taxes against the Debtor, regardless of the effect of the filing of the formal proofs of claims in these proceedings because of the powers or lack of powers of any officer of the State in connection with the filing of these formal proofs of [fol. 48] claims. These claims, he asserts, are secured by liens upon the Debtor's property. In the opinion of the Master, that property is in the custody of the Court, by its Trustees, who have been duly appointed pursuant to Section 77 in these proceedings. That being so, by filing their petition, the Trustees are seeking an opportunity in this Court to defend the property of the Debtor, now in the custody of this Court, against alleged improper claims to that property. In the opinion of the Master, by so doing, the Trustees are not violating the sovereign immunity of the State of New Jersey from suit.

Section 64 (a) of the Bankruptcy Act, dealing with the priority of debts and the order of payment, provides:

> "(a) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be * * * (4) taxes legally due and owing by the bankrupt to the United States or any State or any sub-division thereof; Provided, That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court, and Provided Further, That in case any question arises as to the amount or legality of any taxes; such question shall be heard and determined by the court."

Doubt has been cast upon the applicability of the above section to proceedings under Section 77 by the case of *Arkansas Corporation Commission* v. *Thompson*, 313 U. S., p. 132, but subsequent decisions of District Courts and Circuit Court of Appeals have construed that case as deny-

ing jurisdiction to re-determine the amount of tax claims in limited situations, for example, where the valuation of property has been previously determined by a quasi-judicial taxing body. *Lyford* v. *State of New York*, 140 F. (2d) p. [fol. 49] 840, 2d Circ.; *in re: Monongahela Rye Liquors*, 141 F. (2d) p. 864, 3d Circ.

Both in his brief and on the oral argument, the Attorney General conceded that the Bankruptcy Court has the power as against the State to determine the validity of tax claims of the State, where such claims are unsecured. (Brief, p. 20, citing *New Jersey* v. *Anderson*, 203 U. S., p. 483). The Attorney General makes a distinction between the effect of the State's assertion of unsecured claims and the effect of the State's assertion of secured claims. He argues that when asserting an unsecured claim, the State is applying to be paid out of assets *in custodia legis*, but when the claims of the State are secured by liens, the lien interests of the State are not *in custodia legis* and so any proceedings in this Court affecting those liens, such as the Trustees' petition, is a suit against which the State has sovereign immunity.

In the opinion of the Master, the entire property of the railroad is *in custodia legis*, subject, however, to such rights as are given by law to lienholders. The cases cited by the Attorney General do not hold otherwise. Having custody of the property, the Bankruptcy Court, subject to the limitation expressed in the case of *Arkansas Corporation Commission* v. *Thompson*, 313 U. S., p. 132, *supra*, which limitation is not now involved, is the proper Court to determine the validity and amount of the tax claims of the State of New Jersey and the incidental liens alleged to affect the property in the custody of the Court. *Isaacs* v. *Hobbs Tie & T. Co.*, 282 U. S., p. 734, at p. 738.

It is the opinion of the Master that the claim of the State to sovereign immunity should be denied and that the petition of the Trustees should not be dismissed.

Respectfully submitted, Augustus C. Studer, Jr.,
Special Master.

Dated: January 17th, 1945.

[fol. 50] EXHIBIT "B" TO ANSWER

OPINION

Confirming Special Master's Report

APPEARANCES:

Shelton Pitney, Esq., Walter P. Gardner, Esq., Trustees; Benjamin C. Van Tine, Esq., For the State of New Jersey; Edwin M. Slote, Esq., Attorney for Watters Committee; Blair Reilly, Esq., Attorney for Inst. Group of Bondholders.

FAKE, District Judge:

The issue here arises in a railroad reorganization proceeding under Section 77 of the Bankruptcy Act.

The State of New Jersey through its Comptroller filed certain proofs of claim with the trustees herein for unpaid taxes due the State.

An order of Reference was made by me directing the Special Master, appointed under Section 77(c)(13) of the Act, to hear and report on the amount and validity of said tax claims.

The Attorney General of the State contended before the Master, and as well here, that this court is without jurisdiction to hear and adjudicate the tax claims as in said Order of Reference provided.

The Master has forwarded to this court the record made before him on the subject of jurisdiction, together with the briefs filed before him, and has filed his report thereon holding that this court does have jurisdiction and that the [fol. 51] theory of the sovereign immunity of the State does not apply.

The issue is now before me on motion to adopt and confirm the Master's report.

Upon a consideration of the said Master's report and the record returned therewith, together with the substance of the briefs and oral arguments made before me, I am of the opinion that this court has jurisdiction as asserted and that the Master's report should be adopted and confirmed in all things.

An order will be entered herein overruling the objections and confirming the Master's report.

I will hear counsel on the form of the order.

Filed: February 21, 1945.

EXHIBIT "C" TO ANSWER

Order No. 271 Overruling Objections of State of New Jersey to Interim Report of Special Master Dated January 17, 1945 and Confirming Said Report

This Court by order No. 66 in this cause dated October 7, 1940 having required the claims of all creditors "including all claims of whatever character" against the Debtor "or its property" to be filed by December 31, 1940 in the form and manner prescribed by said order, and the State of New Jersey having thereupon, within time and in the form prescribed by said order, filed its proofs of claim (Nos. 34-38) for balances of taxes alleged to be due to it from the Debtor and for interest or interest penalties on said balances at the rate of 1% per month; and the Trustees having on March 3, 1941 filed objections to said claims, to which the State of New Jersey on March 26, 1941 [fol. 52] filed its "reply of claimant, State of New Jersey, to Trustees' objections to tax claims"; and this Court by Order No. 93 dated April 1, 1941 having referred all disputed claims (including the State's claims aforesaid) to the standing Special Master, "together with all objections thereto, for hearing and report thereon"; and the Legislature of the State of New Jersey having thereupon enacted Chapter 290 of the Laws of New Jersey of 1941, effective July 22, 1941, (subsequently amended by Chapter 241 of the Laws of 1942), known as the Railroad Tax Settlement Act and this Court by Order No. 123 dated August 8, 1941 having authorized and directed the Trustees of the Debtor to comply with said Act and having thereafter by Order No. 135 dated November 24, 1941 adjudicated that the Trustees had taken all steps necessary to comply and should continue to comply with said Act and having by Order No. 163 dated June 12, 1942 revoked so much of said Order No. 93 as referred the State's proofs of claim (Nos. 34-38), as aforesaid, to the standing Special Master for hearing and report thereon; and the United States Circuit Court of Appeals for the Third Circuit having reversed said Order No. 163 in certain other respects, on the appeal of the State of New Jersey, and having remanded the record on said appeal to this Court to await the determination by the Court of Chancery of New Jersey of the constitutionality of said Railroad Tax Settlement Act unless this Court

should find that delay which might be harmful to the Debtor and its creditors might result, in which event this Court might proceed itself to hear and decide the constitutional issue; and following the decisions of the courts of the State of New Jersey in the suit so referred to by the United States Circuit Court of Appeals, this Court having by Order No. 250 dated October 16, 1944 referred and re-referred to the standing Special Master for hearing and [fol. 53] report thereon said tax claims filed by the State of New Jersey, all objections thereto and the State's reply to said objections, and also the State's plea of sovereign immunity from suit filed herein on August 28, 1944, in the form of a special appearance; and supplemental, amended and additional objections and defenses to the State's proofs of claim having thereupon been filed by the Trustees, by the Institutional Group of Bondholders and the Trustees of the Debtor's General Mortgage, and by the Bondholders' Committee known as the Watters Committee, and the State of New Jersey having thereupon filed its further replies to such supplemental, amended and additional objections and defenses; and the Master on December 19, 1944 having taken testimony and heard argument under said Order No. 250 touching the State's plea of sovereign immunity aforesaid and having on January 17, 1945 filed an interim report wherein he concluded, among other things, that the Court has jurisdiction in the premises and that the plea of sovereign immunity should be denied; and the State of New Jersey having thereupon filed objections to said interim report, and said interim report and the State's objections having thereupon been duly brought on for hearing and argument before this Court on February 7, 1945, on notice to all interested parties; and the Court having heard the arguments of Benjamin C. Van Tine, Esq., Deputy Attorney General, on behalf of the State of New Jersey, in opposition to confirmation of said interim report and in support of the State's said objections thereto, and of Shelton Pitney, Esq., one of the Trustees of the Debtor, Blair Reiley, Esq. and Willard P. Scott, Esq., of counsel with the Institutional Bondholders' Group, and Edwin M. Slote, Esq., of Counsel with the Watters Committee, in support of said interim report, and having considered the record herein; and the Court being of opinion that it has jurisdiction to [fol. 54] consider and pass upon the proofs of claim filed

by the State, all objections thereto filed with the Special Master and the State's replies to said objections; and that the State's plea of sovereign immunity is inapplicable and therefore without merit:

It is, on 5 day of March, 1945, Ordered that the objections filed by the State of New Jersey to the interim report of the Special Master dated January 17, 1945 be and the same are hereby overruled, that the Special Master's findings and conclusions as set forth in said report be and they are hereby adopted by this Court and that said report be and the same is hereby confirmed.

Guy L. Fake, United States District Judge.

Filed: March 5, 1945.

IN UNITED STATES DISTRICT COURT

PETITION FOR AN ORDER OF APPROVAL UNDER SECTION 205 TITLE 11, UNITED STATES CODE, AND FOR FURTHER RELIEF

To the Honorable the Judges of t[illegible] District Court of the United States for the District of New Jersey:

* * * * * * *

First: The Debtor is a railroad corporation organized and existing under the laws of the State of New Jersey.

[fol. 55] IN UNITED STATES DISTRICT COURT

PETITION FOR ADJUDICATION CONCERNING NEW JERSEY STATE TAX CLAIMS AND FOR ORDER No. 250

To the Honorable Guy L. Fake, one of the Judges of the United States District Court for the District of New Jersey:

The petition of Shelton Pitney and Walter P. Gardner, Trustees of the properties of the Debtor herein, respectfully shows:

1. Petitioners qualified herein as Trustees of the properties of the Debtor on January 8, 1940. At that time the State of New Jersey claimed that the Debtor owed more

than $13,000,000 for unpaid balances on account of the principal amount of taxes assessed under the Railroad Tax Act for the years 1932 to 1939, both inclusive, as follows:

Year	*State's Claim Allegedly Unpaid Balances, Principal of Taxes*
1932	$2,070,607.32
1933	1,908,577.62
1934	1,556,408.78
1935	1,529,125.79
1936	1,642,352.27
1937	1,435,165.14
1938	1,508,844.94
1939	1,366,368.82

The Debtor had paid the State in and for said years a total of more than $17,000,000 which it asserted was the maximum amount of taxes lawfully assessable.

2. The State of New Jersey also claimed that the Debtor owed the following unpaid balances on account of the principal amount of taxes assessed under the Railroad Tax Act [fol. 56] in respect of the properties of The Dover and Rockaway Railroad Company for the years 1933 to 1939, both inclusive:

Year	*State's Claim Allegedly Unpaid Principal of Taxes*
1933	$ 3,615.38
1934	2,589.94
1935	2,637.88
1936	2,380.73
1937	2,224.54
1938	2,025.96
1939	4,443.06
Total	$19,917.49

3. The State of New Jersey also claimed that the Debtor owed the following unpaid balances on account of the principal amount of taxes assessed under the Railroad Tax Act

in respect of the properties of The Ogden Mine Railroad Company for the years 1933 to 1939, both inclusive:

Year	*State's Claim Allegedly Unpaid Principal of Taxes*
1933	$2,909.23
1934	2,279.44
1935	559.60
1936	631.96
1937	583.22
1938	623.26
1939	1,358.02
Total	$8,944.73

[fol. 57] 4. All of said tax claims were then in litigation in other tribunals except the claims for the years 1932 and 1933. Earlier litigation concerning the claims for those years had resulted unfavorably to the Debtor. Threats by the State of New Jersey to enter a judgment or judgments against the Debtor upon said claims and to sell the railroad properties of the Debtor located within the State of New Jersey forced the Debtor to file its petition in bankruptcy herein on October 30, 1939.

5. Shortly thereafter the District Court of the United States for the District of New Jersey, sitting as a court of equity, made and entered a decree enjoining the State of New Jersey from collecting or attempting to collect more than 70% of such taxes purportedly assessed by the State of New Jersey for the years 1934, 1935 and 1936.

Like decrees were simultaneously entered in favor of various other railroads. The State of New Jersey appealed or purported to appeal from said decrees to the Circuit Court of Appeals for the Third Circuit, but in respect of the decree so entered in favor of the Debtor failed and neglected to join your petitioners as parties respondent; and your petitioners did not appear in or become parties to the purported proceedings before the Circuit Court of Appeals and did not join in either of the applications made by other railroads for a rehearing by said Court and a writ of certiorari from the Supreme Court of the United States, both of which applications were denied.

6. From the time of their qualification on January 8, 1940 as aforesaid to August 8, 1941 your petitioners, as officers of this Court actively and in good faith litigated the aforementioned tax claims of the State of New Jersey for the years 1937, 1938 and 1939 but, by authority of this Court, paid an additional $900,000 on account of the State's [fol. 58] tax claims for the years 1932 and 1933 by installment payments of $150,000 each on July 1, August 1, September 1, October 1, November 1 and November 30, 1940, thereby reducing the total claims of the State of New Jersey for the principal amount of unpaid taxes for the years 1932-1939, inclusive, to $12,117,450.68.

In addition, your petitioners, on February 8, 1940, paid on account of taxes claimed in respect of the properties of The Dover & Rockaway Railroad Company, the sum of $6,281.22, thereby reducing the principal taxes claimed in that respect to $13,636.27, and on account of taxes claimed in respect of the properties of The Ogden Mine Railroad Company the sum of $3,724.04, thereby reducing the principal taxes claimed in that respect to $5,220.69.

7. Also by authority of this Court petitioners contested the 1940 tax assessed by the State upon their railroad properties in New Jersey in the sum of $3,303,213.18 and paid the State $1,981,927.91 (or 60%) which they believed was the maximum amount lawfully assessable for said year, leaving a balance claimed by the State for said year of $1,321,285.27. For the same reason and by like authority they caused to be paid 60% of the taxes assessed for 1940 in respect of the properties of their affiliated companies, and contested said assessments.

For the same reason and by like authority petitioners contested the taxes assessed by the State for the year 1941, until the Legislature of the State of New Jersey enacted the Railroad Tax Settlement Act hereinafter referred to and until petitioners accepted and in good faith complied with all of the conditions thereof and assumed all of the burdens imposed thereby.

8. On December 10, 1940 the State of New Jersey, by Frank J. Murray, Comptroller of the Treasury of New [fol. 59] Jersey, filed a proof of claim in these proceedings for the unpaid balances of taxes allegedly owing from the estate of the Debtor for the years 1932 to 1939, inclusive, in

the total amount of $12,117,450.68 with interest thereon in the sum of $7,732,339.53 to December 1, 1940, and interest from December 1, 1940 to the date of payment. A true copy of said proof of claim, No. 38, is hereto annexed as Schedule "A".

9. At the same time the State of New Jersey also filed in these proceedings the following proofs of claim for the following unpaid balances of taxes assessed in respect of the properties of the following companies, respectively:

No.	Name of Company	Amount of Principal Claimed	Amount of Interest Claimed to December 1, 1940
34	The Ogden Mine Railroad Company	$ 5,229.69	$ 5,149.19
35	The New York and Long Branch Railroad Company	318,305.30	140,495.05
36	The Dover and Rockaway Railroad Company	13,636.27	9,302.82
37	The Bay Shore Connecting Railroad Company	5,528.40	3,601.50

together with interest from December 1, 1940 to date of payments.

10. Petitioners filed objections to said proofs of claim Nos. 34, 35, 36, 37 and 38. A true copy of their objections to claim No. 38 is hereto annexed as Schedule "B". Petitioners were advised, *inter alia*, that the tax claims for years 1932 to 1939, inclusive, and as well the taxes assessed for the year 1940, were predicated upon the application of an "average tax rate" for each of said years [fol. 60] which had been computed in violation of the Constitution and statutes of the State of New Jersey and that said tax rate was grossly inflated because of the intentional, systematic and fraudulent under-assessment of real estate in the State of New Jersey taxable under the General Tax Act and the intentional systematic and fraudulent under-assessment and non-assessment of personal property taxable under said General Tax Act, and particularly the intentional, systematic and fraudulent omission to include intangible personal property in the ratables taxed under said Act (except as to some of the years the in-

tangible personal property of a few corporations or estates in a very few of the hundreds of taxing districts of the State). Said intentional, systematic and fraudulent exclusion of intangible personal property and under-assessment of other property generally resulted in the use of a false, unlawful and grossly deflated denominator in striking the tax rate applicable to the Debtor and to petitioners, as Trustees of the Debtor's properties. Petitioners were advised and were prepared to establish in support of their objections that they were without remedy in the courts of the State of New Jersey for the aforesaid intentional, systematic, fraudulent and discriminatory method of assessing property, except by proceedings to correct each under-assessment and failure to assess, that a taxpayer cannot be limited to that remedy,—which is no remedy at all,—and that for a state to so limit a taxpayer's remedy is to deny him his constitutional rights; that the grossly inflated tax rate resulting from the intentional, systematic and fraudulent non-assessment and under-assessment of property under the General Tax Act, for which, as aforesaid, the Debtor had been and your petitioners were without remedy in the state courts, had deprived and by virtue of the action of the State of New Jersey in seeking to enforce and collect taxes based on such grossly inflated tax [fol. 61] rate was threatening to deprive the Debtor's estate and your petitioners as Trustees thereof of its and their property without due process of law in violation of the Fourteenth Amendment of the Constitution of the United States; that such deprivation and denial of due process could be promptly remedied only in this Court; and that under such circumstances this Court was not only vested with jurisdiction to hear and adjudicate the tax claims of the State of New Jersey for the years 1932 to 1940, inclusive, but was obliged in the performance of its bankruptcy powers and duties so to do and to determine the amounts of the State's claims, if any, when lawfully computed in conformity with the Constitution and statutes of the State of New Jersey.

11. On April 1, 1941 this Honorable Court made and entered herein its Order No. 93 referring said proofs of claim of the State of New Jersey for the years 1932 to 1939 (with other disputed claims) to the Honorable Augustus C. Studer, Jr., as Special Master, together with all objections thereto, for hearing and report thereon.

12. Meanwhile, the Governor of the State of New Jersey had appointed a committee to investigate the railroad tax problem which had resulted to a major extent from such annual application of a grossly inflated tax rate, as aforesaid, and said committee on February 22, 1941 made a comprehensive report which was subsequently considered by a committee of the Legislature of the State of New Jersey and by the Legislature itself, with the result that the Legislature enacted Chapters 290 and 291 of the Laws of 1941, approved and effective July 22, 1941.

13. By the provisions of Chapter 290 of the Laws of 1941 the State Treasurer was authorized and required to accept, without interest penalties, installment payments of [fol. 62] the full balance of the principal amout of the taxes assessed for the years 1932 to 1940, inclusive, which remained unpaid on July 22, 1941, provided that a railroad taxpayer complied with the requirements of Sections 7 and 8 of said Act, which provided as follows:

"7. Undertaking; first payment. Any railroad or system, or the receiver, trustee or trustees thereof, may enter upon the execution of an installment payment plan authorized under this act by (1) duly executing and filing with the State Comptroller a written undertaking, in such form as the Attorney-General shall prescribe, for the payment of the total amount of delinquent taxes owed by the railroad or system and (2) paying into the State treasury an amount not less than the first annual installment together with interest on the unpaid balance computed in the manner provided by sections two, three and four of this act.

"8. Waivers. The first payment tendered pursuant to this act shall be accompanied by a waiver of any and all rights to contest the legality or amount of any assessment made prior to December first, one thousand nine hundred and forty-one, together with stipulations, consents or other papers for the discontinuance and dismissal of all suits, actions, and proceedings pending in any court or before the Board of Tax Appeals concerning such assessments, all in such form as the Attorney-General may require."

14. Thereupon on August 8, 1941 this Court, after considering said offer of compromise, made and entered herein its Order No. 123, authorizing petitioners to accept the compromise of said tax claims offered in and by said Chapter 290 by agreeing to pay the full unpaid balance [fol. 63] of the principal amounts of taxes claimed by the State of New Jersey for the years 1932 to 1940, inclusive, viz., the principal amout of $13,438,669.19, said payments to be made in installments over a period of twenty years, as authorized and provided for in said act, without penalties but with interest at the rate of 3% per annum computed from December 1, 1940, as required by the terms of said offer. At the same time and by the same order your petitioners were authorized to tender and pay the full unpaid balance of the principal amount of taxes claimed in respect of the properties of The Dover and Rockaway Railroad Company amounting to $15,185.44, and the full unpaid balance of the principal amount of taxes claimed in respect of the properties of The Ogden Mine Railroad Company amounting to $5,776.23.

15. Petitioners thereupon caused to be filed with and delivered to the appropriate officers of the State all of the documents and payments required for full compliance by them and by The Dover and Rockaway Railroad Company and The Ogden Mine Railroad Company with the conditions of said offer and the provisions of said Order No. 123; and also caused to be filed with and delivered to the appropriate officers of the State all of the documents and payments required for full compliance by the The New York and Long Branch Railroad Company and by The Bay Shore Connecting Railroad Company.

16. Thereafter and on September 4, 1941, one David T. Wilentz, then Attorney General of the State of New Jersey, instituted a proceeding in the Court of Chancery of New Jersey known as a civil information suit, wherein "David T. Wilentz, Attorney General of the State of New Jersey" was named as "Informant" and the State Treasurer was named as "Defendant". No other party was [fol. 64] named or appeared in said suit. Therein said Informant prayed an injunction against the State Treasurer from carrying out the provisions of said Chapter 290 and alleged that said chapter was in violation of Article I, Paragraph 20, of the Constitution of the State of New

Jersey, which provides that "no donation of land or appropriation of money shall be made by the state or any municipal corporation to or for the use of any society, association or corporation whatever."

17. Pursuant to Order No. 107 of this Court dated June 9, 1941 and before the enactment of Chapter 290 of the Laws of that year petitioners had appealed to the New Jersey State Board of Tax Appeals from the assessment of railroad taxes made by the State for the year 1941. In view of their acceptance of and compliance with the provisions of Chapter 290 including their waiver as thereby required of any and all rights to contest the legality or amount of any assessment made prior to December 1, 1941, petitioners felt compelled to pay the 1941 taxes in full and they therefore applied to this Honorable Court for aid, instructions and authority in the premises in view of the steps taken by them so to comply as in their petition set forth. Petitioners recited, *inter alia*, the institution of the civil information suit referred to in Paragraph 16 hereof, the enactment of Chapter 291 of the Laws of 1941 and the adoption by the Legislature of the State of New Jersey in November 14, 1941 of a concurrent resolution directing the Joint Legislative Committee on Railroad Taxation to study the operation of the 1941 railroad tax laws and to report thereon to the then session of the Legislature with any recommendations tending to improve the administration of said laws or to make more certain the attainment of the objectives sought by the Legislature in the passage of said laws (including the objective to so revise the rail-
[fol. 65] road tax law that taxes on the railroads would be reduced). Petitioners' said application was heard by this Honorable Court on November 24, 1941 and on said date this Court made and entered its Order No. 135 wherein and whereby it found, adjudicated and decreed, *inter alia*, that petitioners had taken all steps necessary to comply with the provisions of said Chapter 290, that no objection had been made by the Comptroller, the Treasurer or the Attorney General of the State of New Jersey as to the form or validity of any of the undertakings, waivers, stipulations, etc., which petitioners had filed pursuant to said chapter and that in view of such compliance with the requirements of said chapter and their waiver of any and all rights which they had to contest the legality

or amount of any assessment made prior to December 1, 1941, petitioners should pay the full amount of the taxes assessed for the year 1941. Petitioners promptly complied with said order and paid said full amount.

18. Thereafter, the Legislature enacted Chapter 169 of the Laws of 1942, approved and effective May 8, 1942, amending certain of the provisions of Chapter 291 of the Laws of 1941. Said statute (Chapter 169) so amended the franchise tax provisions of said Chapter 291 as to levy a retroactive franchise tax against petitioners for the preceding tax year, 1941, in the amount of $239,749.80 and so increase their tax burden for that year by said sum, while at the same time said statute (Chapter 169) provided for a reduction in the franchise taxes assessed for said year 1941 against most of the other railroads operating in the State of New Jersey and for the complete elimination of said franchise taxes as to certain other railroads operating in the State of New Jersey and thus decreased their respective tax burdens retroactively for said year. Petitioners show that said Chapter 169 arbitrarily and unjustly discriminated as between members of a single class [fol. 66] of taxpayers, all of such railroad taxpayers being subject to taxation under the Railroad Tax Act of the State, as amended; singled petitioners out as victims of arbitrary recomputation of the 1941 railroad franchise taxes, while at the same time financially benefiting other railroad taxpayers; and denied to petitioners and to Debtor the equal protection of the laws in violation of the Fourteenth Amendment of the Constitution of the United States; and that in purporting to assess a retroactive franchise tax against petitioners for the year 1941 deprived them and the Debtor of their and its property without due process of law in violation of the Fourteenth Amendment of the Constitution of the United States; and petitioners were preparing at the time of the enactment of the statute next referred to to challenge the constitutionality of said Chapter 169 and the assessment or levy of any franchise tax thereunder against petitioners for the year 1941.

19. Thereupon the Legislature of the State of New Jersey enacted Chapter 241 of the Laws of 1942, approved and effective May 21, 1942, amending in various respects said Chapter 290 of the Laws of 1941.

20. Said Chapter 241 added various burdens and conditions to those imposed upon petitioners and upon the Debtor's estate by the act which it amended (said Chapter 290, Laws of 1941). Among other things, it provided that "any railroad taxpayer desiring to accept the provisions of this act shall, on or before June fifteenth, one thousand nine hundred and forty-two, file with the State Treasurer the acceptance documents required by this act, * * * waiving any and all rights to contest the legality or amount of any assessment on its property used for railroad purposes made prior to December first, one thousand nine hundred and forty-one, pursuant to the ap-
[fol. 67] plicable tax acts, *and of any assessment heretofore or hereafter made for the tax year one thousand nine hundred and forty-one* * * *." Accordingly, your petitioners were required unequivocally to abandon their contemplated challenge of the retroactive franchise tax for the year 1941 in the amount of $239,749.80, hereinabove referred to, and to incorporate in their "acceptance document" their written waiver of "any and all rights to contest the legality or amount" of said retroactive franchise tax assessment, and also any other tax that might thereafter be assessed for said year, or risk the contention that they had abandoned their acceptance of the State's offer or had failed in all respect to comply therewith in good faith. Petitioners were also required by said Chapter 241 to make an additional interest payment on or before June 15, 1942 in an amount exceeding $340,000, such additional interest resulting from the requirement of accelerated payment of interest and the requirement that interest be computed from December 1, 1940 upon the entire principal amount of taxes claimed by the State as of that date, without deducting therefrom the first installment of principal previously paid as alleged in paragraph 15 hereof. Petitioners were advised that there was grave doubt as to the validity of the legislative action in adding these and other burdens and conditions after petitioners' acceptance in 1941 of the offer then made by the State (Chapter 290, Laws of 1941), but in view of the specific requirements and time limit provided for in said Chapter 241 this Court on June 12, 1942 made and entered its Order No. 163 in this proceeding directing petitioners on or before June 15, 1942 to comply and agree to comply in the future in all respects with said Chapter 241, while at

the same time recognizing and reciting that there was ground for serious doubt as to whether the principal amount of taxes claimed by the State was legally due.

[fol. 68] 21. Petitioners thereupon fully complied in all respects with said Chapter 241 not only as to the taxes assessed by the State of New Jersey against the Debtor or petitioners for the years 1932 to 1940, inclusive, but also as to all taxes claimed from petitioners on account of taxes assessed in respect of the properties of The Dover and Rockaway Railroad Company and The Ogden Mine Railroad Company,—and waived any and all right to contest the legality or amount of said retroactive franchise tax for 1941, which said tax petitioners paid in good faith and without contest and for the recovery whereof the laws of the State provide no right or remedy. They also paid, as required, said additional interest. Petitioners also caused to be filed and delivered to the appropriate officers of the State all of the documents and payments required for full compliance with the terms of said Chapter 241 by The New York and Long Branch Railroad Company and The Bay Shore Connecting Railroad Company.

22. After petitioners had so complied and had caused the four affiliated companies above named to comply with said Chapter 241 of the Laws of 1942 and had in good faith waived all such rights of contest and had paid without contest the aforesaid retroactive franchise tax of $239,749.80 and the additional and accelerated interest aforesaid, the Court of Chancery of the State of New Jersey on September 28, 1943 made and entered a final decree in said civil information suit a copy of which final decree is hereto annexed as Schedule "C". The opinion of the Vice-Chancellor who advised said decree is reported, 133 N. J. Eq. 447. Thereupon said State Treasurer appealed from said decree to the Court of Errors and Appeals of New Jersey, which affirmed said final decree by a vote of ten to four. The majority and dissenting opinions are reported, 135 N. J. Eq. 244, 261.

[fol. 69] 23. As will more fully and at large appear by reference to the opinions hereinabove cited, the decisions of the New Jersey courts that Chapter 290 of the Laws of 1941, as amended by Chapter 241 of the Laws of 1942, contravenes Article I, Paragraph 20, of the Constitution of

the State of New Jersey, were rested upon a finding of fact. That finding was that there was no "substantial and valuable consideration" and no "moral or equitable consideration" received by the State for the "remission, cancellation and abatement" of what was concluded to be a part of the "tax debt" in which the State of New Jersey had a "vested interest," to wit, for the remission, cancellation and abatement of interest at 1% per month on what (without the presence as parties of petitioners or any other party similarly situated) the New Jersey courts found or assumed to be due the State on account of unpaid balances of taxes. Thus, the question of local or State law decided by the State courts was that a remission of interest on railroad taxes unsupported by consideration is violative of said paragraph 20. To the extent that the State courts purported to find as a fact that there was no substantial and valuable consideration and no moral or equitable consideration to the State for the remission of interest claimed from petitioners and the Debtor's Estate, and so purported to try *ex parte* all of petitioners' pending railroad tax cases and their objections in this Court to the State's proofs of claim herein,—with only officers of the adverse tax claimant as parties,—no question of local or State law or policy was involved. The purely factual conclusion, if such it was intended to be, was in nowise controlling upon petitioners or this Honorable Court. If, however, the State courts merely assumed said conclusion of fact, then there is no decision either of local or any other character which the State may urge upon this Honorable Court.

[fol. 70] 24. Petitioners show that neither Chapter 290 of the Laws of 1941 nor Chapter 241 of the Laws of 1942 required acceptance by all of the railroads affected but permitted and authorized acceptance of the legislative offer by "any" one or more of them and that both statutes expressly recognized the different degrees of their burdens that would be involved in their acceptance of the offer made and in complying with the provisions of the law and prescribed a "burden index" and formula for deferred installment payments over a period of not less than two nor more than twenty years measured by "the respective capacity to pay of each". Said "burden index" was to be determined as to any acceptor by dividing the total amount of its unpaid tax claims as of December 31, 1940 "by the

five-year average of its net railway operating income" for the years 1936 to 1940, inclusive, and by affording it the number of whole years "next greater than seven times its 'burden index'" for its installment payments.

Petitioners became entitled under said formula to make installment payments over the maximum period of twenty years.

25. Petitioners further show that Section 12 of Chapter 290 of the Laws of 1941 provides as follows:

> "12. Effect of unconstitutionality. If any provision of this act, or the application thereof to any person or circumstances, is held invalid, the remainder of this act, or application of such provision to other persons or circumstances, shall not be affected thereby.",

and that Section 15 of Chapter 241 of the Laws of 1942 also provides:

> "15. If any provision of this act or the application thereof to any person or circumstances is held invalid, [fol. 71] the remainder of this act, or the application thereof to other persons or circumstances, shall not be affected thereby."

26. Petitioners are prepared to prove that there were many valuable considerations, and, as well, moral and equitable consideration, for the presupposed remission, cancellation and abatement of the interest claimed by the State of New Jersey from your petitioners on the unpaid balances of taxes claimed by the State of New Jersey from your petitioners. Among said considerations, upon which the Legislature of the State of New Jersey was justified in relying and must be presumed to have relied are the following:

> (1) In and by said laws the State, by its Legislature, exacted as a condition of the proposed compromise that petitioners make an unqualified and unconditional promise to pay the full amount of the taxes claimed by the State even though they were still in controversy and were not being collected. The Legislature of New Jersey knew that the State's claims for taxes and interest were being litigated by petitioners as officers of this court, with the knowl-

edge and approval and under the direction of this Court, and therefore knew that all of the State's claims were being contested in good faith and because this Court believed in the performance of its duties that there were fairly debatable questions of law and fact that had to be determined in the interest of the Debtor's estate and a fair and equitable reorganization thereof. The Legislature would not have been justified in assuming and may not be presumed to have assumed that the litigation so being waged by your petitioners would be resolved against your petitioners either because earlier litigation in which the [fol. 72] unlawful tax rate had not been urged had resulted unfavorably to the Debtor or otherwise. The Legislature must be presumed to have known the law of the State of New Jersey to be, as pronounced by its courts, that tax assessments are made each year and that each annual assessment of property for taxation is a separate entity, distinct from the assessment of the previous or subsequent years; also that property to be assessed is to be taken and valued in the actual condition in which the owner holds it. All that the State proposed to give up in return for such unqualified and unconditional promise, notwithstanding the debatable character of the claim, was a claim for interest, if any, on said disputed and unliquidated claim for taxes;

(2) At the time of the enactment of said Chapter 290, approved and effective July 22, 1941 the cash position of the Debtor, its need for liquid working capital and its requirements for administration and reorganization expenses were such that it was evident any plan that might be devised and promulgated for the reorganization of the Debtor pursuant to Section 77 of the Bankruptcy Act (11 U. S. C. A., Section 205) would necessarily fall far short of providing for a cash payment to the State of New Jersey equal to even the State's claim for unpaid balances of taxes, if allowed, quite apart from any interest claim;

(3) It was uncertain what character or amount of securities would or could be authorized by the Inter-

state Commerce Commission and court for issuance in satisfaction of the State's tax claims to the extent, if any, that they might ultimately be allowed, and whether any such securities would be fixed interest [fol. 73] bonds or income bonds or stock, or a combination of any two or more thereof, and what interest or dividend rates upon any such securities might be authorized, and, to the extent of any authorized income bonds or preferred stock whether the same would be non-cumulative or wholly or partly cumulative, and what the maturity date of any such bonds might be; and what the market value of any such securities might prove to be;

(4) The State's lien for any allowed tax claim or claims could be of no avail during the pendency of the bankruptcy proceedings herein because no such lien could be enforced by a sale of any of the Debtor's railroad properties while the same were *in custodia legis* under Section 77 of the Bankruptcy Act and because this Court, in conformity with the very purpose of Section 77, had enjoined the State of New Jersey from any proceedings to enforce its tax claims;

(5) Any lien of the State, even if enforceable, would have been of doubtful value because necessarily limited in scope to the properties of the Debtor located within the State of New Jersey, which said properties had been and were operated at a loss and the operation whereof at a profit, if separately acquired and operated, would have been difficult or impossible;

(6) Any lien of the State, even if enforceable, would have been of doubtful value because upon the foreclosure of such lien and the acquisition by the State of New Jersey of the properties of the Debtor within the State, the State would lose such properties as a source of tax revenues as long as it continued to own the properties and would also risk operating deficits from State operation and ownership;

[fol. 74] (7) There was doubt under applicable authorities whether the State had a lien for interest accruing on the taxes covered by the proofs of claim filed by the State.

(8) Successful or partially successful prosecution by the State of its aforesaid proofs of claim filed in these proceedings would have required an adjudication also by this Court of difficult questions involving the priority of claims by the Debtor's bondholders upon the quick assets in the hands of petitioners in view of the source of these assets and the necessity for using earnings from the Debtor's mileage outside New Jersey upon which the bondholders had a lien and the State had none, for the maintenance, betterment, improvement and operation of the properties of the Debtor within the State of New Jersey to which any lien of the State was limited by statute and constitutional law;

(9) Litigation as to the grossly inflated tax rate to which reference has hereinabove been made would have revealed that the long succession of equalization statutes enacted by the Legislature of the State for the very purpose of correcting the discriminatory abuses which resulted in such grossly inflated tax rate had been so neglected and disregarded that the State was under a moral obligation and legal duty to the Debtor and to petitioners to make fair and equitable amends for said neglect;

(10) There was doubt under applicable authorities whether the State could in any event claim interest at any rate during the period of the Debtor's bankruptcy upon taxes which had become payable prior to the date of such bankruptcy, the Debtor's railroad [fol. 75] property being *in custodia legis*, and further, at what rate such interest, if any, would be allowed;

(11) It was uncertain whether any plan of reorganization promulgated by the Interstate Commerce Commission and approved by this Court would authorize the issuance, as of some earlier date, of the new securities to be authorized, from which unfixed date no further interest or penalties would have accrued on the State's claim;

(12) The Debtor's railroad properties in New Jersey had been and at the time of the enactment of said Chapter 290 were largely terminal properties whose

review of this petition that the State is not so bound and that petitioners are likewise not bound, then petitioners are [fol. 78] advised that equity would require this Honorable Court to take all such steps as might be appropriate to restore the equivalent of the *status quo ante* and so avoid gross prejudice and inequity to all other creditors and persons interested in the Debtor's Estate. In such event this Court would be required fully to consider and adjudicate the rights of the State of New Jersey under its proofs of claim herein and petitioners' objections thereto and also the relative rights and priorities of the State and other lienholders in the assets of the Estate and, in particular, the quick assets thereof.

31. Reorganization of the Debtor has long been delayed because of the pendency of the civil information suit, disposition whereof has at last turned upon questions which can neither bind petitioners nor govern the provisions of a reorganization plan.

32. Before a plan can be formulated or promulgated it will be necessary for this Honorable Court to consider and adjudicate the matters herein mentioned or some of them. Petitioners show that prompt consideration and adjudication thereof is essential and that further delay could only serve to prejudice all parties in interest and, as well, the public interest.

33. Petitioners further show that on or before December 1, 1944 they will be required by their agreement filed under said Chapter 290 of the laws of 1941 as amended by said Chapter 241 of the Laws of 1942 to make an additional installment payment to the State of New Jersey on account of the principal amount of the taxes claimed by the State together with an additional interest payment; and that petitioners will require the aid, instructions and protection [fol. 79] of this Court in the premises prior to December 1, 1944 and particularly an adjudication by this Court whether they entered into a contract with the State of New Jersey and should continue to perform the same by making such additional payment on account of principal and such additional interest payment.

Wherefore petitioners pray that this Honorable Court, the premises considered, may promptly adjudicate (1) whether petitioners entered into a contract with the State

of New Jersey, (2) whether such contract is binding on the parties thereto, (3) whether, if not binding on the State, petitioners are nonetheless bound by the prejudicial actions taken by them, (4) if not binding on the parties thereto including petitioners, to what extent, if at all, the proofs of claim of the State of New Jersey should be allowed, (5) what order should in such event be made to restore the equivalent of the *status quo ante* as nearly as may be and (6) what in such event are the relative rights, claims, liens and priorities of the claimants in the assets of the Debtor's Estate; and that this Honorable Court may instruct petitioners whether to make on or before December 1, 1944 the additional payment on account of the taxes claimed and the additional interest payment required by Chapter 290 of the Laws of 1941, as amended by Chapter 241 of the Laws of 1942.

And your petitioners will ever pray.

Shelton Pitney, Walter P. Gardner, As Trustees of The Central Railroad Company of New Jersey.

Dated: August 12, 1944.

[fol. 80] UNITED STATES OF AMERICA,
Southern District of New York,
City and County of New York, ss:

Shelton Pitney, being duly sworn according to law on his oath deposes and says that he is one of the petitioners in the foregoing petition named, that he has read said petition and that the matters and things therein set forth are true, except as to those matters alleged on information and belief, and that as to such matters he verily believes the same to be true.

Shelton Pitney.

Subscribed and sworn to this 12th day of August, 1944, before me (S.) Mary A. McNamara, Notary Public, Bronx Co., No. 30, Reg. No. 45-Mc-5. Cert. filed in N. Y. Co., No. 295, Reg. No. 167-Mc-5. Commission expires March 30, 1945. (Seal.)

[fol. 84] (10) Lien, priority or preferential classification, if any, claimed for the claim, or any part thereof, the reasons therefor and full statement of the facts respecting same:

The statute of New Jersey provides that these taxes shall be a lien paramount to all other liens upon all the lands and tangible property and franchises of the company in this State (Section 9, Chapter 208, P. L. 1888, as amended and supplemented; Section 54:27-4, Revised Statutes). The lien shall take effect on June 1 of the year in which the tax is payable.

(11) The Central Railroad Company of New Jersey claim or correspondence file numbers, if any, relating to claim or any item thereof and to offsets or counterclaims:

(12) Name and address of person authorized by claimant to receive and receipt for dividends or payments:

William H. Albright, State Treasurer of New Jersey, State House, Trenton, N. J.

(13) Name and address of attorney authorized to represent claimant:

David T. Wilentz, Attorney General, State House, Trenton, N. J.

(14) If proof of claim is executed or verified by a person other than claimant, the reasons therefor and the character of the authority of the persons so executing or verifying the proof of claim are:

State of New Jersey, Name of Claimant, by (S.) Frank J. Murray, Comptroller of the Treasury of N. J. (Title.)

Dated at Trenton, N. J., December 10, 1940.

(*Be sure to execute affidavit on next page*)

[fol. 85] STATE OF NEW JERSEY,
County of Mercer, ss.:

FRANK J. MURRAY being first duly sworn, on oath deposes and says that he is the Comptroller of claimant herein; that he has been duly authorized to execute, verify

and file the foregoing proof of claim; that he has knowledge of the facts therein stated; that the same are true and correct; that said claim is justly owing from the Debtor to the claimant, and that the amount now due claimant from THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, the Debtor, on claims arising prior to October 30, 1939, after allowing all credits, offsets, and counterclaims, is $19,849,790.21 plus additional interest as claimed in answer to (2).

(S.) Frank J. Murray.

Subscribed and sworn to before me this 15th day of Dec. 1940. (S.) Owen W. Kite, Notary Public. My Commission expires Oct. —, 1944. (Seal.)

Follow instructions of the Court as stated in its Order No. 66, dated and filed October 7, 1940, to wit:

"Each claim shall be filed in triplicate with Charles E. Jaeckel, Chief Deputy Clerk at Newark, at his office, Room 347 P. O. Bldg., Newark, N. J."

[fol. 86]

Department of Comptroller of the Treasury

State of New Jersey

Statement of Railroad Taxes Fixed, Collections Thereof, and Taxes and Interest Due for Years 1932 to 1939 Both Inclusive

By the Central Railroad Company of New Jersey, Debtor

Classification of Tax and Year	Last Day Payable Without Interest	Amount of Tax	COLLECTIONS Date	COLLECTIONS Amount	Taxes Not Paid	Interest to Dec. 1, 1940	Total Tax and Interest Now Due
FIRST CLASS							
For the year 1932	Dec. 1, 1932	$ 2,372,866.16	12- 1-32	$ 720,000.00	$	$	$
			3-12-37	154,387.09			
			7- 1-40	108,553.59			
			8- 1-40	108,553.58			
			9- 1-40	108,553.59			
			10- 1-40	108,553.59			
			11- 1-40	108,553.59			
			11-30-40	75,975.07	879,736.86	1,500,843.74	2,380,579.80
1933	Dec. 1, 1933	2,145,190.95	12- 1-33	901,975.72			
			3-12-37	170,619.76			
			11-30-40	41,601.03	1,030,994.44	967,595.30	1,998,589.74
1934	Dec. 1, 1934	2,126,613.77	12- 1-34	1,137,787.28			
			1-28-37	138,180.98	850,645.51	648,399.74	1,499,045.25
1935	Dec. 1, 1935	1,987,943.48	12- 1-35	1,073,489.48	795,177.39	493,823.68	1,289,001.07
			1-28-37	119,276.61			
1936	Dec. 1, 1936	1,959,791.36	12- 1-36	1,097,483.16	862,308.20	413,907.94	1,276,216.14
1937	Dec. 1, 1937	1,874,577.67	12- 1-37	1,124,746.61	749,831.06	269,939.18	1,019,770.24
1938	Dec. 1, 1938	1,932,529.53	12- 1-38	1,159,517.71	773,011.82	185,522.84	958,534.66
[fol. 87] 1939	Dec. 1, 1939	1,706,740.27	12-27-39	1,024,044.16	682,696.11	75,994.36	758,690.47
Totals First Class Taxes		$16,106,253.19		$ 9,481,852.60	$6,624,400.59	$4,556,026.78	$11,180,427.37
SECOND CLASS							
For the Year 1932	Dec. 1, 1932	$ 1,775,908.02	12- 1-32	$1,200,000.00	$	$	$
			9-30-38	3,779.77			
			7- 1-40	41,446.41			
			8- 1-40	41,446.42			
			9- 1-40	41,446.41			
			10- 1-40	41,446.41			
			11- 1-40	41,446.41			
1933	Dec. 1, 1933	1,683,486.25	12- 1-33	705,812.04	364,896.19	545,656.22	910,552.41
			3-12-37	135,931.08			
			9-30-38	5,760.98			
			11-30-40	32,423.90			
For the Year 1934	Dec. 1, 1934	1,773,373.98	12- 1-34	948,795.87	803,558.25	758,643.22	1,562,201.47
			1-28-37	115,228.52			
			9-30-38	3,586.32			
1935	Dec. 1, 1935	1,844,197.34	12- 1-35	995,866.56	705,763.27	539,765.28	1,245,528.55
			1-28-37	110,651.84			
			9-30-38	3,730.54			
1936	Dec. 1, 1936	1,782,105.70	12- 1-36	997,979.19	733,948.40	457,145.86	1,191,094.26
			9-30-38	4,082.44			
1937	Dec. 1, 1937	1,722,325.04	12- 1-37	1,033,395.02	780,044.07	375,319.29	1,135,363.36
			9-30-38	3,595.94			
1938	Dec. 1, 1938	1,849,582.20	12 -1-38	1,103,749.69	685,334.08	247,079.86	932,413.94
			9-30-38	9,999.39			
1939	Dec. 1, 1939	1,709,181.78	12-27-39	1,025,509.07	735,833.12	176,599.95	912,433.07
					683,672.71	76,103.07	759,775.78
Total Second Class Taxes		$14,140,160.31		$ 8,647,110.22	$ 5,493,050.09	$ 3,176,312.75	*$ 8,669,362.84

* Plus Additional Interest at the Rate of 1% per Month from December 1, 1940 to Date of Payment.

expenses for terminal facilities and terminal operations, including taxes assessed upon a total valuation thereof far exceeding any possible capitalizable value, were so great that it could not hope to attract new capital for improvements or betterments, or, indeed, to survive, if the State could have succeeded in collecting all of the taxes claimed together with all of the interest claimed thereon, so that even if the State could have exacted its pound of flesh it would have deprived a large number of its citizens of that railroad service which it is its purpose to insure.

27. The foregoing considerations for Chapter 290 of the Laws of 1941 were also consideration for Chapter 241 of the Laws of 1942, and as will more fully and at large appear by reference to paragraphs 18 to 21, inclusive hereof, substantial additional benefits to the State and detriments to petitioners and to the Debtor's estate flowed from the enactment of said Chapter 241 and petitioners' compliance therewith.

[fol. 76] 28. The settled law of the State of New Jersey for many decades prior to the decision in *Wilentz* v. *Hendrickson*, hereinabove cited, had been, and at the time of the enactment of Chapter 290 of the Laws of 1941 and Chapter 241 of the Laws of 1942 and when petitioners accepted the statutory offer made by the State was, that interest on unpaid taxes was not a part of the tax in which the State had any vested right, but was a method of enforcing the payment and was in the nature of a remedy for its non-payment; and that control thereover was within the province of the Legislature.

29. Petitioners allege that their contract was valid when made both for the reason that as a matter of law the State did not agree to appropriate or part with any sum whatsoever in which it had a vested interest and that as a matter of fact it received both good and valuable and moral or equitable consideration for that which it did agree to do,—or for either of said reasons. Petitioners are advised that a contract valid when made cannot be impaired by a subsequent change in judicial decision and that this would be true as to their contract even had they been parties to the proceeding in which such change occurred. Petitioners show however that only officers and agents of

their adverse tax claimant were parties to the litigation hereinabove referred to and that the changed judicial decision is in nowise controlling on petitioners or this Honorable Court.

30. The State of New Jersey has not offered to restore the *status quo ante* either in whole or in part. On the contrary its officers and agents assert not only that the case of *Wilentz* v. *Hendrickson*, hereinabove cited, is binding upon petitioners notwithstanding the matters and things herein alleged but that petitioners are none the less [fol. 77] bound on their part by their actions taken under the contract. Thus this claimant demands the fruits of changed judicial decision and of a finding of fact in a proceeding to which its officers and agents refrained from making petitioners parties together with the fruits of all action taken by petitioners in reliance on and compliance with its legislative action. Moreover the State has threatened and is threatening to make huge tax claims against the Debtor's Estate for the tax years 1932 to 1940, inclusive, in addition to and in excess of the amounts demanded and set forth in its proofs of claim for the years 1932 to 1939, inclusive, and the previously claimed balance of $1,321,285.27 for the year 1940. It has also threatened and is now threatening to deny the validity of the provision of Section 4 of Chapter 290 of the Laws of 1941 as amended by Chapter 241 of the Laws of 1942 which provided that from and after December 1, 1940 petitioners would be required annually to pay interest at the rate of 3% per annum on the unpaid balances and installments of the principal amount of taxes claimed by the State. The State has threatened and is now threatening also to deny that the various actions taken by petitioners in acceptance of and compliance with the aforesaid legislation and in compliance with the orders of this Court are to be given effect as of the time said actions were taken by petitioners or at all. Petitioners are advised that these last mentioned threats of new claims never previously asserted by the State against petitioners and in various respects wholly inconsistent with the State's previous position are and will remain of academic importance unless and until this Honorable Court has adjudged not only that the State is not bound by its contract with petitioners but also that petitioners are on their part bound thereby. If, however, this Honorable Court should adjudge upon a

[fol. 81] UNITED STATES OF AMERICA,
Southern District of New York,
City and County of New York, ss:

Walter P. Gardner, being duly sworn according to law on his oath deposes and says that he is one of the petitioners in the foregoing petition named, that he has read said petition and that the matters and things therein set forth are true, except as to those matters alleged on information and belief; and that as to such matters he verily believes the same to be true.

Walter P. Gardner.

Subscribed and sworn to this 12th day of August, 1944, before me (S.) Mary A. McNamara, Notary Public, Bronx Co., No. 30, Reg. No. 45-Mc-5. Cert. filed in N. Y. Co., No. 295, Reg. No. 167-Mc-5. Commission expires March 30, 1945. (Seal.)

[fol. 82] SCHEDULE A

Proof of Claim No. 38

PROOF OF CLAIM ARISING PRIOR TO OCTOBER 30, 1939

against

THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, Debtor

(To be executed and filed in triplicate)

(1) Name, address and business of claimant.

State of New Jersey, State House, Trenton, N. J.

(2) Total amount of claim:

$12,117,450.68 taxes, plus interest thereon in the sum of $7,732,339.53, plus additional interest on said unpaid taxes from December 1, 1940 to date of payment.

(3) Detailed statement of claim showing nature of claim and of each item thereof, the consideration therefor, and the dates of accrual and the amounts of each item, with such details as shall definitely advise the Trustees of the par-

ticulars thereof, and distinguish the claim from other claims of like nature:

(Attach rider or other sheets, if necessary.)

Said claim represents unpaid balances of taxes assessed and levied by the State of New Jersey upon property and franchises of the Debtor for the years 1932 to 1939, both inclusive (pursuant to "An act to revise and amend 'an act for the taxation of railroad and canal property' approved April 10, 1884," approved March 27, 1888, its amendments and supplements and Chapters 19 to 29, both inclusive, of Title 54, [fol. 83] Revised Statutes,) as detailed in the annexed writings marked schedule "A" and schedule "B". Under said statute all taxes not paid on December 1, of the year for which same are assessed and levied shall bear interest from December 1 of said year until payment.

(4) Security or lien, if any, for said claim:

Answered in (10) below.

(5) Copies of original documents. (Original promissory notes, contracts, orders, or other written documents, if any, on which claim is based should be copied and the copies attached to each copy of proof of claim):

(6) Partial payments, if any, heretofore made:

$18,128,962.82. All partial payments shown in detail in Schedules "A" and "B" attached.

(7) Details and amounts of offsets or counterclaims due to the Debtor or the Trustees against said claim:

No offsets or counterclaims.

(8) Net amount due claimant:

$19,849,790.21, plus additional interest as indicated in (2).

(9) Court, title and number of suit or proceeding, if any, in which said claim is involved or pending; whether judgment has been recovered thereon, and if so, date and amount of such judgment:

See writing attached hereto, marked "Schedule C".

[fol. 88] SCHEDULE "C"

Paragraph 9 of Claim

Following is a statement of the Courts and reviewing agencies, title and number of suit or proceedings in which the assessments, taxes, and interest thereon for the several years involved in this claim have been and are now in litigation.

1932 and 1933 Assessments, Taxes and Interest

(a) Reviewed on appeal to and sustained by the State Board of Tax Appeals. 1932 case unreported. 1933 case recorded in N. J. B. T. A. Rep. 1912-1934, 675; 57 N. J. L. J. 115.

(b) 1933 tax reviewed on certiorari by the New Jersey Supreme Court and sustained. 114 N. J. L. 69.

(c) 1933 tax reviewed on Bill in Equity by the United States District Court, District of New Jersey. Bill dismissed on final hearing by final decree entered March 6, 1937. No. E-5050. Decision reported as Central R. R. Co. *v.* Martin, 19 Fed. Supp. 82 (merits decided on same record reported as Lehigh Valley R. Co. *v.* Martin, 19 Fed. Supp. 63).

(d) Foregoing decree affirmed by United States Circuit Court of Appeals, Third Circuit, No. 6438; reported under Erie Railroad Company *v.* J. H. Thayer Martin, et al., 100 Fed. (2d) 139. Application to United States Supreme Court for writ of certiorari denied, 59 S. Ct. 592; 83 L. Ed. 1049. Rehearing denied, 59 S. Ct. 784; 83 L. Ed. 1063.

[fol. 89] *Schedule "C"—Paragraph 9 of Claim*

1934, 1935 and 1936 Assessments, Taxes and Interest

(a) Reviewed on appeal to and sustained by State Board of Tax Appeals. The 1936 tax decision unreported. The 1934 and 1935 decisions reported in N. J. B. T. A. Rep. 1934-1939, 83, 231.

(b) Injunctions restraining collection of part of the taxes decreed by United States District Court, District

of New Jersey. Opinion reported under title Central R. R. Co. of N. J. *v.* Martin, State Tax Commissioner, et al., 30 Fed. Supp. 41. These decrees were appealed to the United States Circuit Court of Appeals, Third Circuit, were argued before that Court on October 21, 1940. Judgments of District Court reversed. Opinion filed November 27, 1940.

1937, 1938 and 1939 Assessments, Taxes and Interest

(a) Same were appealed to the State Board of Tax Appeals, but as yet have not been determined by that body.

[fol. 90]

SCHEDULE B

Objections to Proof of Claim No. 38

Name of Claimant:

State of New Jersey.

Address:

State House, Trenton, New Jersey.

Basis of Claim:

This claim, amounting to $12,117,458.68 plus interest thereon in the sum of $7,732,339.53, plus additional interest on the total of said sums from December 1, 1940, is alleged to represent unpaid balance of taxes levied by the State of New Jersey upon the property of the Debtor for the years 1932 to 1939 inclusive.

Objections:

The Debtor and the Trustees of the property thereof, jointly and in the alternative, expressly reserving all rights of the Debtor and of the Trustees in respect of said claim, including the right to amend this objection and to make more definite any part thereof, object to the above claim on the following grounds, hereby denying each and every affirmation of the Proof of Claim inconsistent herewith,—

As to Taxes Generally for the Years 1932 to 1939, Inclusive

As the State's Proof of Claim shows, the Debtor has already paid to the State over $18,128,000 on account of

the taxes levied against it for the years 1932 to 1939, inclusive. The Debtor and the Trustees allege that the taxes lawfully levied against the Debtor for said respective years [fol. 91] have been paid in full and they object to the claim now asserted on the ground that the additional amounts claimed are wholly unlawful and void because based upon assessments that are excessive, discriminatory, arbitrary and unlawful, for the following reasons,—

(a) The State Tax Commissioner in making the assessments failed and refused to give any weight to the drastic and permanent decline in the earnings of the Debtor resulting not only from the depression but from radical changes in the transportation industry which became apparent by the year 1931.

(b) Said Commissioner failed and refused to consider and give any weight to the fact that said railroad properties in the State of New Jersey are by operation of law dedicated to public use for transportation purposes and are therefore subject to intensive public regulation as to control, operation and earnings under the Acts of Congress and of the State Legislature.

(c) Each item of land included in the assessment was grossly over-valued by having ascribed to it the excessive valuation of adjacent land devoted to other uses and without regard to the peculiar status and function of the Debtor's land as a part of a railroad system, or to its true value, in disregard of the State Law as defined by the Courts of New Jersey. A substantial element in the valuation of much of the land adjacent to the Debtor's land is its accessibility to the railroad and yet the Tax Commissioner in assessing the railroad land indulged in the fiction that the railroad land might be marketed in separate parcels valued according to adjacent land values which obviously would not survive abandonment of the railroad.

(d) Each structure was valued independently according to its cost less depreciation, and in complete disregard [fol. 92] of its present market value or true value as a part of an operating railroad property.

(e) The method of assessment of Debtor's property followed by the State Tax Commissioner in making the assessments for the years 1932 to 1939, inclusive, was unlawful

and arbitrary in that while for many years prior thereto, when the sum of the valuations ascribed to the tangible items of the property was deemed to be less than the true value of the total property in New Jersey, a corrective was added representing "remaining value including the franchise"; but in making the assessments for the years 1932 to 1939, respectively, when the true value of the Debtor's property in New Jersey as a whole was less than the sum of the valuations ascribed to the separate items of tangible property, no corrective deduction was made.

(f) The State Tax Commissioner failed and refused to consider and give any weight to the fact that the many separately inventoried items of porperty comprising the Debtor's railroad system in the State of New Jersey constitute a public service unit which is not susceptible to disintegration, sale or disposal by parcels or items.

(g) In assessing each parcel of land and each structural item included in said property, the State Tax Commissioner disregarded the fact that the sale, disposal or encumbrance of the property constituting Debtor's railroad facilities is rigidly restricted by law.

(h) The said assessment of Debtor's properties was unjustly and illegally discriminatory and involved a denial of the equal protection of the laws in violation of the Fourteenth Amendment to the Federal Constitution in that said assessment was in excess of the true value thereof, while other real property generally in the State of New Jersey, excepting property of railroad companies, is customarily, [fol. 93] notoriously, intentionally and systematically assessed for taxation at not more than 80% of the ascertainable value thereof; and while the personal property of the Debtor, including its locomotives, cars and other equipment, was assessed in excess of true value, the personal property of taxpayers other than railroads is generally, notoriously, systematically and intentionally omitted from taxation, and when taxed, is systematically and intentionally assessed for taxation at less than half of the ascertainable value thereof.

(i) The said tax levy on Debtor's property was arbitrary and illegally discriminatory and involved a denial of due process and of the equal protection of the laws in violation of the Fourteenth Amendment to the Federal Constitution, in that while all of the railroad property of the

Debtor in the State of New Jersey, other than its second class railroad property, was subject to the "average tax rate" computed as provided by Revised Statutes 54:24-2 and 54:24-3, said average tax rate as computed and applied by the Tax Commissioner in fixing the tax levy on the Debtor's property was grossly inflated in disregard of said statutes. As stated in the preceding paragraph, real and personal property, other than railroad property, generally throughout the State was assessed at substantially less than true value, yet the Tax Commissioner computed the "average tax rate" which was used in fixing each of the tax levies referred to in the Proof of Claim by dividing the total taxes levied on real and personal property in all of the taxing districts throughout the State, by the aggregate *assessed value* of all locally assessed real and personal property including second class railroad property instead of by dividing said total taxes levied by the aggregate *true value* of all such locally assessed property.

(j) By reason of the erroneous, excessive and arbitrary valuation as aforesaid of the said railroad properties per- [fol. 94] sisted in over a period of years the said assessments constitute a constructive fraud and the levying and imposing of taxes thereon based upon such erroneous, fraudulent, excessive and unlawful valuations, deprive the Debtor of its property without due process of law and deny the equal protection of the laws in contravention of the provisions of the Fourteenth Amendment to the Constitution of the United States.

(k) The said assessments of Debtor's property for each of said years were grossly in excess of its true value in direct contravention of Article IV, Section VII, Paragraph 12, of the Constitution of the State of New Jersey, which requires that

> "Property shall be assessed for taxes under general laws and by uniform rules according to its true value."

(l) Since the Debtor is an important agency of interstate transportation, the said assessments of Debtor's property for each of said years, to the extent that they are in excess of true value, constitute an interference with and burden upon interstate commerce, in violation of the provi-

sions of Article 1, Section VIII of the Constitution of the United States.

(m) As shown by the record in this proceeding (printed record pp. 1 to 6), the additional taxes now claimed by the State of New Jersey constituted one of the chief reasons why the Debtor was compelled to seek relief under the Bankruptcy Act and as further shown by the record (printed record 1091 to 1139), the alleged current as well as accrued tax liability of the Debtor to the State of New Jersey precludes the formulation by the Debtor of any plan of reorganization, as contemplated by Section 77 of the Bankruptcy Act. The Debtor, therefore, alleges that [fol. 95] to the extent that the assessments on its property by the State of New Jersey referred to in the Proof of Claim are in excess of true value, they constitute an interference with the exercise by Congress of its bankruptcy powers, in violation of Article I, Section VIII, Paragraph 4 of the Constitution of the United States.

(n) The State Tax Commissioner and the New Jersey State Board of Tax Appeals in reviewing the assessments for the years 1932 to 1936, inclusive, and the New Jersey Supreme Court in reviewing the assessments for the year 1933 arbitrarily excluded from the evidence considered or refused and neglected to consider and give any weight to, the evidence submitted by the Debtor showing that the assessments in question were grossly excessive, discriminatory, arbitrary and unlawful.

(o) As to the assessments for the years 1934, 1935 and 1936, this Court, by its Order No. 83, has reserved for further decision the question whether a petition for a writ or writs of certiorari should be filed with the United States Supreme Court respecting the decision of the Third Circuit Court of Appeals dated November 27, 1940, which is referred to in the State's Proof of Claim.

(p) As to the assessments for the years 1937, 1938 and 1939 appeals were promptly filed by the Debtor with the New Jersey State Board of Tax Appeals and they are still pending undetermined.

(q) Notwithstanding the various proceedings referred to in the Proof of Claim relating to the assessments for each of the years involved, all of the questions raised by

the Proof of Claim and by these objections thereto as to the amount and legality of the taxes claimed are for the determination of this Court under Section 64(a) of the Bankruptcy Act.

[fol. 96] (r) The assessments for each of the years involved are for the reasons above stated or one or more of them and in other respects arbitrary, unconstitutional and illegal and the statutes under which they were made as construed and applied in making said assessments are unconstitutional and illegal.

As to Interest

1. The claimant is not entitled to collect any interest on the balances of taxes alleged to be due from the Debtor, or any part thereof, after the date when the Debtor filed its Petition in Bankruptcy, to wit, October 30, 1939.

2. If the claimant is entitled to collect any interest on said balances, or on any part thereof, after October 30, 1939, the rate of interest is limited to the legal rate fixed by the Laws of the State of New Jersey, to wit 6% per annum, instead of the rate 1% per month from October 30, 1939, to the date of payment as asserted in the Proof of Claim.

3. The taxes due from the Debtor to the State of New Jersey prior to October 30, 1939, having been paid in full prior to said date, no further amount is due for the alleged balances of taxes, or any part thereof, or for interest alleged to be due on said balances, or for any part thereof.

4. Even if any part of the alleged balances of taxes for any of said years were ultimately found to be due, no interest would accrue thereon during the period or periods that the collection thereof was enjoined in a judicial proceeding in which the Debtor was, in good faith, contesting the validity thereof, and as to the taxes for the years 1937, 1938 and 1939 no interest has accrued because the question as to the lawful amount of the assessments for those years is still pending on appeal before the State Board [fol. 97] of Tax Appeals, and no delinquency in payment of a tax can arise until there has been an administrative determination of the amount of tax lawfully due.

Wherefore, said Debtor and Trustees pray that said claim and each part thereof be wholly disallowed.

Dated: February 27, 1941.

The Central Railroad Company of New Jersey by Shelton Pitney and Walter P. Gardner, Trustees; and Shelton Pitney and Walter P. Gardner, Trustees of the Property of the Central Railroad Company of New Jersey, By Shelton Pitney, Walter P. Gardner, Trustees.

To: David T. Wilentz, Esq., Attorney General, State House, Trenton, N. J.

[fol. 98] SCHEDULE C

FINAL DECREE—Filed September 28, 1943

This cause being opened to the Court by David T. Wilentz, Attorney-General of New Jersey, informant, solicitor *pro se*, in the presence of Herbert J. Hannoch, solicitor of the defendant;

And it appearing that a stipulation, dated September 28, 1943, has been entered into by the parties and filed in Court;

And the Court, at final hearing, having duly considered such stipulation and having fully considered the evidence submitted and the arguments of counsel;

And it appearing to the Court upon such consideration that Chapter 290 of the Laws of 1941 and Chapter 241 of the Laws of 1942 are in contravention of Article I, Section 20, of the Constitution of the State of New Jersey;

It is therefore, on this twenty-eighth day of September, 1943,

Ordered, Adjudged and Decreed

1. That Chapter 290 of the Laws of 1941 and Chapter 241 of the Laws of 1942 are in contravention of Article I, Section 20, of the Constitution of the State of New Jersey, and are null and void.

2. That the defendant, Robert C. Hendrickson, State Treasurer, his successors in office and his and their respective agents and servants, be and they are hereby each, severally, permanently restrained and enjoined from carry-

ing out or executing any and all of the provisions of Chapter 290 of the Laws of 1941 and of Chapter 241 of the Laws of 1942, and from accepting from any railroad taxpayer any acceptance documents, discharges or dismissals, dis-
[fol. 99] continuances checks or other forms of payment which may be delivered to him or them or which were heretofore delivered to him or them in purported compliance with Chapter 290 of the Laws of 1941 and Chapter 241 of the Laws of 1942, and from depositing any such checks or other forms of payment or distributing the proceeds thereof.

Respectfully advised, Luther A. Campbell, C., Wilfred H. Jayne, V.-C.

I hereby approve the foregoing final decree as to form only.

Herbert J. Hannoch, Solicitor of the Defendant;
Robert C. Hendrickson, State Treasurer.

[fol. 100] In United States District Court

Special Appearance of Walter D. Van Riper, Attorney General of the State of New Jersey, for the Sole Purpose of Objecting to the Jurisdiction of the Court to Entertain "Petition for Adjudication Concerning New Jersey State Tax Claims and for Order No. —," —Filed by the Trustees Herein on August 12, 1944.

Walter D. Van Riper, Attorney General of the State of New Jersey, having been served with a printed form of petition entitled "Petition for Adjudication Concerning New Jersey State Tax Claims and for Order No. —," which said petition is signed by Shelton Pitney and Walter P. Gardner, trustees of the property of the debtor, and is dated August 12, 1944, does herewith specially appear in response to said petition for the sole purpose of interposing an objection to the entertainment of the said petition by this Honorable Court, on the ground that same constitutes the prosecution of a suit, claim or demand against the State of New Jersey by a citizen or citizens of the State of New Jersey, and that the judicial power of the courts of the United States does not, under the Constitution of the United States, extend to any suit, claim or demand brought or instituted against the State of New Jersey, either by the

debtor railroad company, a corporation of New Jersey, or by the petitioning trustees, residents of the State of New Jersey, and in respect of such objection Walter D. Van Riper, Attorney General of the State of New Jersey, more particularly shows as follows:

1. Said petition appears upon its face to pray, as against the State of New Jersey, for an order adjudging and determining that the State of New Jersey has entered into a valid and subsisting contract with the trustees under and by virtue of Chapter 290 of the Laws of 1941, and Chapter 241 of the Laws of 1942, (which said laws have been adjudged null and void in and by a final decree of the New [fol. 101] Jersey Court of Chancery by the terms of which the execution or consummation of said laws on behalf of the State was permanently enjoined, a copy of which decree, which has been affirmed by the New Jersey Court of Errors and Appeals is annexed to the said petition of the trustees as schedule C); by reason of which the trustees claim that the tax debt of the debtor and of the trustees due to the State of New Jersey, and the State's lien therefor, have in somewise been affected, altered, modified or destroyed.

In said respect the petition is, therefore, the maintenance of a suit, claim, or demand against the State of New Jersey by citizens thereof, beyond the judicial power or jurisdiction of any court of the United States to entertain, as aforesaid.

2. Said petition appears upon its face to assert the existence of equitable rights, privileges and immunities of the debtor and of the trustees as against the State of New Jersey, and to request from this Honorable Court equitable adjudications and determinations with respect to the tax obligations of the debtor and of the trustees to the State of New Jersey, for which the State has liens, which adjudications and determinations do or may affect such tax obligations or liens lawfully assessed and imposed against the debtor and the trustees by the duly constituted taxing authorities of the State of New Jersey under the laws of the State.

In said respect the petition is, therefore, the maintenance of a suit, claim, or demand against the State of New Jersey, by citizens thereof, beyond the judicial power or jurisdiction of any court of the United States to entertain, as aforesaid.

3. The said petition appears in divers other respects to invoke the supposed jurisdiction of this Honorable Court to [fol. 102] enter determinations and adjudications which may or will affect, modify, impair or destroy the tax obligations owing by the debtor and by the trustees herein to the State of New Jersey, and the liens of the State therefor, and in said respects the filing of the petition and the prosecution thereof constitute a suit, claim, or demand against the State of New Jersey, by citizens thereof, beyond the judicial power of the courts of the United States to entertain, as aforesaid.

Wherefore, the said Walter D. Van Riper, Attorney General of the State of New Jersey, appearing specially as aforesaid, moves this Honorable Court that the said petition shall be dismissed insofar as same prays for or seeks an adjudication or determination that the claims of the State of New Jersey for taxes and interest thereon are less than such sums as have been assessed against the debtor and the trustees by the duly constituted authorities of the State, or have lawfully accrued, pursuant to the laws of the State; and insofar as the liens of the State for such taxes and interest are sought in anywise to be altered, affected, modified or destroyed, by any such adjudication or determination.

Respectfully submitted, Walter D. Van Riper, Attorney General of the State of New Jersey, appearing specially.

[fol. 103] IN UNITED STATES DISTRICT COURT

ORDER NO. 250 RE-REFERRING TO SPECIAL MASTER THE DISPUTED TAX CLAIMS OF THE STATE OF NEW JERSEY, ALL EXISTING OR ADDITIONAL OBJECTIONS THERETO AND THE STATE'S REPLY TO SAID OBJECTIONS, AND ALSO REFERRING THE STATE'S MOTION TO DISMISS THE TRUSTEES' PETITION DATED AUGUST 12, 1944 FOR AD-UDICATION OF SAID CLAIMS.

The Trustees of the Debtor having filed herein a petition, dated August 12, 1944, for an adjudication concerning New Jersey State tax claims, and it appearing to the Court that on December 10, 1940 there were filed on behalf of the State of New Jersey proofs of claim as set forth in paragraphs 8 and 9 of said petition of the Trustees, and that the Trustees filed objections to said proofs of

claim as set forth in paragraph 10 of said petition of the Trustees, and that on March 26, 1941 the State of New Jersey filed a reply to said objections to proofs of claim so filed by the Trustees; and it appearing further that this Court, on April 1, 1940, entered Order No. 93, referring said proofs of claim to Augustus C. Studer, Jr. Esq., as Special Master, which Order of Reference was revoked by Order No. 163 in these proceedings; and it appearing further that there have been various subsequent developments, as set forth in said petition of the Trustees dated August 12, 1944, which involve questions of fact and questions of law and mixed questions of fact and law; and the State of New Jersey, by its Attorney General, having purported to appear specially to said petition of the Trustees dated August 12, 1944 and challenged the jurisdiction of this Court in the premises on the ground that it may not be sued without its consent and that it has not consented to be sued as more fully set forth in the State's motion to dismiss; and it having been represented by the Trustees and Intervenors to the Court that there are questions of fact which have or may have a bearing on [fol. 104] said special appearance by the State of New Jersey and upon the question whether this Court has jurisdiction in the premises; and it further appearing that adjudication with respect to this Court's jurisdiction and, if jurisdiction there be, upon the issues presented by the State's proofs of claim, the Trustees' objections thereto and the State's reply to said objections must be made as expeditiously and promptly as possible in order that the reorganization proceedings of the Debtor may be progressed and terminated as soon as possible; and this Court having considered all of the facts alleged in said petition of August 12, 1944 of the Trustees, and in said special appearance of the Attorney General of the State of New Jersey, and having heard all of the parties,

It Is, on this 16th day of October, 1944, on motion of the Trustees, Ordered:

1. That all tax claims filed by the State of New Jersey, the Trustees' objections thereto and the State's reply to said objections, and also the aforesaid purported special appearance of the State objecting to the jurisdiction of this Court filed herein on August 28, 1944 be and the same

are Hereby Referred and Re-Refered to Augustus C. Studer, Jr., Esq., as Special Master, for hearing and report theeron.

2. That the said Special Master be and he hereby is directed to take testimony and hear argument, make findings of fact, adopt conclusions of law and submit the same to the Court as his report, either with or without opinion, as said Special Master may consider necessary, calling to his aid, if he deems it advisable, a stenographer, to the end that the testimony may be taken and transcribed and filed; that said Special Master shall regulate the proceedings and all hearings before him, shall have full authority [fol. 105] to examine the parties upon, or in regard, to, any matter arising before him in pursuance to this order of reference, and, also to secure by subpoena and subpoena *duces tecum*, the appearance of witnesses and the production of documents; to examine on oath all witnesses produced by the parties before him or to require the taking of testimony by deposition in accordance with the Acts of Congress and the General Orders in Bankruptcy; and to direct the mode in which the matters requiring evidence shall be proved before him; and the form and contents of the report, with opportunity for objections thereto, shall be as provided by the rules of this Court.

3. That the Trustees or any party to this proceeding may within such time as the Master may prescribe file amended, revised, supplemental or additional objections to the proofs of claim heretofore filed by the State of New Jersey, as aforesaid, and that the State of New Jersey, without prejudice to its purported special appearance aforesaid, may within such time as the Master may prescribe file such amended, revised, supplemental or additional reply as it may be advised to any such objections.

4. That this Court hereby reserves the right to revise, alter and amend this order.

Guy L. Fake, United States District Judge.

Filed: October 6, 1944.

[fol. 106] IN UNITED STATES DISTRICT COURT

NOTICE OF APPEAL—Filed October 31, 1944

To The Central Railroad Company of New Jersey, Debtor, and Shelton Pitney and Walter P. Gardner, Trustees of The Central Railroad Company of New Jersey, Debtor, Central Hanover Bank and Trust Company, Trustees of the Debtor's General Mortgage, Institutional Group of Lienors, Brooks Committee of Bondholders, and To Whom It May Concern:

SIRS:

Notice is hereby given that the State of New Jersey, by Walter D. Van Riper, Attorney General, hereby appeals to the United States Circuit Court of Appeals for the Third Circuit from the whole of the Order of the Court No. 250, entered in these proceedings on October 16, 1944, which order is entitled "Order No. 250 Re-Referring to Special Master the Disputed Tax Claims of the State of New Jersey, All Existing or Additional Objections Thereto and the State's Reply to Said Objections, and Also Referring the State's motion to Dismiss the Trustee's Petition dated August 12, 1944 for an Adjudication of Said Claims."

Walter D. Van Riper, Attorney-General for State of New Jersey, Appellant.

Dated: October 30, 1944.

[fol. 107] IN UNITED STATES DISTRICT COURT

SUPPLEMENTAL AND AMENDED OBJECTIONS AND DEFENSES OF DEBTOR'S TRUSTEES TO CLAIMS FILED BY THE STATE OF NEW JERSEY

A. To. Claim No. 38 for $19,849,790.21

(The Central Railroad Company of New Jersey)

1. Claim No. 38 for $19,849,790.21 is in an amount which exceeds by $7,732,339.53 plus $66.76* the maximum

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* The item of $66.76 represents a minor adjustment made by the State Board of Tax Appeals for the tax year 1937, while the item of $7,732,339.53 represents the State's claim for interest penlties at 1% per month to December 1, 1940.

amount which the State of New Jersey may lawfully claim to be due under or by virtue of its Statutes viz., Chapter 290 of the Laws of 1941 and Chapter 241 of the Laws of 1942, with which Statutes the undersigned Trustees of the Debtor have duly complied pursuant to orders of this Bankruptcy Court.

2. The difference amounting to $12,117,383.92, plus a balance of $1,321,285.27 claimed by the State of New Jersey to be due from the Trustees on account of taxes purportedly assessed for the tax year 1940, making a total of $13,438,669.19, became and is payable not, as claimed, at one time or in one payment, but in installments, in the amounts, at the times, upon the terms and in the manner prescribed by said Statutes.

3. The Trustees have paid on account of said sum of $13,438,669.19 or have duly tendered payment of the sum of $2,432,352.91. The balance of $11,006,316,28 is payable in installments, in the amounts, at the times and upon the terms and in the manner so prescribed.

4. By the provisions of said Statutes any remedy of or proceedings by the State of New Jersey to collect any [fol. 108] part of said claim is now and will hereafter continue to be stayed and suspended as long as the Trustees and their successor or successors make the required installment payments in the amounts, at the times, upon the terms and in the manner so prescribed.

5. Alternatively, if the State of New Jersey contends herein that its aforesaid Statutes are without force or effect as applied to the Trustees and to the Debtor's Estate and such contention is allowed and sustained, then for the reasons and upon the grounds set forth in paragraphs 6 and 7 hereof and in the Trustees' "Objections to Proof of Claim No. 38" dated February 27, 1941 (which objections are hereby incorporated herein by reference thereto), the following portions of Claim No. 38 and the State's claim in respect of the year 1940 must be disallowed:

Tax Year	*Total Tax and Interest Claimed*
1934	$2,744,573.80
1935	2,480,095.33
1936	2,431,579.50

1937	1,952,117.42
1938	1,870,967.73
1939	1,518,466.25
1940	1,321,285.27
Total	$14,319,085.30*

* And, as well, the additional interest claimed by the State at the rate of 1% per month from December 1, 1940.

6. The State's last mentioned tax claims are predicated upon its application to other than second class property of an "average tax rate" and the application to second class [fol. 109] derived from computations based upon under-property of various and sundry local tax rates which were valuation of other taxable property and failure to value still other taxable property, which undervaluations, and omissions were in violation of the Constitution and Statutes of the State of New Jersey. Said tax rate were grossly inflated because of the intentional, systematic and fraudulent under-assessment of real estate taxable under the General Tax Act and the intentional, systematic and fraudulent under-assessment and non-assessment of personal property taxable under said General Tax Act, and particularly the notorious omission to include intangible personal property in the ratables taxed under said Act (except sporadically and fractionally in a very few of the hundreds of taxing districts of the State, the intangible personal property of a few corporations or estates). The State of New Jersey and its agents failed to correct said unlawful under assessment and non-assessment of property under the General Tax Act notwithstanding legislative, executive and administrative recognition of such unlawful practices; and the statutes of the State enacted to correct said abuses were not carried into effect and became dead letters. Such exclusion of intangible personal property and under-assessment of other property generally and the State's failure to make effective its corrective or "equalization" statutes resulted in the use of false, unlawful and grossly deflated denominators in striking the tax rates applicable to the Debtor and to its Trustees, and thereby in the levy of taxes against it and them in violation of the Constitution and statutes of the State.

7. Debtor and its Trustees were and are without adequate remedy in the courts of the State of New Jersey for the aforesaid unlawful method of taxation and unlawful tax rate bases under the interrelated statutes, the General Tax Act and the Railroad Tax Act. The aforesaid viola- [fol. 110] tions of the Constitution and the statutes of the State, the failure of said corrective or "equalization" statutes to correct and the action of the State in seeking nevertheless to enforce and collect its aforesaid tax claims based on such grossly, unlawfully and admittedly inflated tax rates, without affording an adequate remedy therefor, threatened to deprive the Debtor of its property without due process of law in violation of the Fourteenth Amendment of the Constitution of the United States.

8. Upon the hypotheses stated in paragraph 5 hereof the Trustees have paid to the State and the State has accepted the sum of $239,749.80 on account of the State's claims in addition to the sum of $2,432,352.91 paid or duly tendered as hereinbefore in paragraph 3 set forth. Furthermore, in compliance with the instructions of this Bankruptcy Court and the provisions of said Statutes the Trustees have tendered on account of the State's claims the following sums on the following dates respectively:

Date of Check	*Amount*
August 8, 1941	$279,939.37
June 12, 1942	340,816.69
November 30, 1942	173,862.60
December 1, 1943	350,717.95
Total	$1,145,336.61

9. As to that portion of the State's claim which is for interest:

(a) In no event can such claim be allowed for the period commencing October 30, 1939 in an amount in excess of interest at the rate of 6% per annum to December 1, 1940 and 3% per annum thereafter on such unpaid principal balances of the State's tax claims as [fol. 111] may be allowed (less the interest payments heretofore made or duly tendered by the Trustees);

(b) The claim for interest penalties at the rate of 1% per month for the periods during which the State's

tax claims were being contested in good faith and collection was enjoined by judicial decree or statute is a claim for penalties which must be disallowed under and by virtue of Section 57(j) of the Bankruptcy Act (11 U. S. C. A. Section 93(j)); and

(c) The State is without any lien for any such interest claim as may be allowed;

(d) No interest is payable as to any amounts of principal of taxes claimed to the extent that the claim for such principal is disallowed or to the extent of the amounts heretofore paid or tendered under the Settlements Acts and the orders of the Bankruptcy Court.

10. The State is without any lien upon the Debtor's or the Trustees' personal property.

B. To Claim No. 34 for $10,369.88

(Ogden Mine Railroad Company)

1. Claim No. 34 for $10,369.88 is in an amount which exceeds by $5,149.19 the maximum amount which the State of New Jersey may lawfully claim to be due under or by virtue of its Statutes, viz., Chapter 290 of the Laws of 1941 and Chapter 241 of the Laws of 1942, with which Statutes the undersigned Trustees of the Debtor have duly complied pursuant to orders of this Bankruptcy Court.

[fol. 112] 2. Following the enactment of said Statutes the Trustees on or about August 11, 1941 paid the full principal amount of taxes claimed of $5,220.69, plus an additional sum of $555.54 the principal amount of taxes for the year 1940, plus $120.32 interest prescribed by said Chapter 290 of the Laws of 1941, and on June 15, 1942, in compliance with said Chapter 241 of the Laws of 1942, paid an additional amount for interest in the sum of $146.50.

3. Alternatively, upon the hypotheses stated in paragraph 5 of part "A", *supra*, the allegations of paragraphs 6, 7 and 9(a), (c) and (d) thereof are hereby repeated and the Trustees' "Objections to Proof of Claim No. 34" filed February 27, 1941 are hereby incorporated herein by reference thereto.

4. No balance is due the State under Claim No. 34.

C. Claim No. 35 for $458,800.35

(New York and Long Branch Railroad Company)

1. Claim No. 35 for $458,800.35 is in an amount which exceeds by $140,495.05 the maximum amount which the State of New Jersey may *un*lawfully claim to be due under or by virtue of its Statutes, viz., Chapter 290 of the Laws of 1941 and Chapter 241 of the Laws of 1942, with which Statutes the undersigned Trustees of the Debtor have duly complied pursuant to orders of this Bankruptcy Court.

2. Following the enactment of said Statutes the Trustees on or about August 11, 1941 paid the full principal amount of taxes claimed of $318,305.30, plus an additional sum of $59,981.90 the principal amount of taxes for the year 1940, plus $7,877.38 interest prescribed by said Chapter 290 of the Laws of 1941, and on June 15, 1942, in com-
[fol. 113] pliance with said Chapter 241 of the Laws of 1942, paid an additional amount for interest in the sum of $9,452.00.

3. Alternatively, upon the hypotheses stated in paragraph 5 of part "A", *supra*, the allegations of paragraphs 6, 7 and 9(a), (c) and (d) thereof are hereby repeated and the Trustees' "Objections to Proof of Claim No. 35" filed February 27, 1941 are hereby incorporated herein by reference thereto.

4. No balance is due the State under Claim No. 35.

D. To Claim No. 36 for $22,939.09

(Dover and Rockaway Railroad Company)

1. Claim No. 36 for $22,939.09 is in an amount which exceeds by $9,302.82 the maximum amount which the State of New Jersey may lawfully claim to be due under or by virtue of its Statutes, viz., Chapter 290 of the Laws of 1941 and Chapter 241 of the Laws of 1942, with which Statutes the undersigned Trustees of the Debtor have duly complied pursuant to orders of this Bankruptcy Court.

2. Following the enactment of said Statutes the Trustees on or about August 11, 1941 paid the full principal amount of taxes claimed of $13,636.27, plus an additional sum of $1,549.17 the principal amount of taxes for the

year 1940, plus $316.35 interest prescribed by said Chapter 290 of the Laws of 1941, and on June 15, 1942, in compliance with said Chapter 241 of the Laws of 1942, paid an additional amount for interest in the sum of $385.09.

3. Alternatively, upon the hypotheses stated in paragraph 5 of part "A", *supra*, the allegations of paragraphs 6, 7 and 9(a), (c) and (d) thereof are hereby repeated and the Trustees' "Objections to Proof of Claim No. 36" filed [fol. 114] February 27, 1941 are hereby incorporated herein by reference thereto.

4. No balance is due the State under Claim No. 36.

E. To Claim No. 37 for $9,129.90

(Bay Shore Connecting Railroad Company)

1. Claim No. 37 for $9,129.90 is in an amount which exceeds by $3,601.50 the maximum amount which the State of New Jersey may lawfully claim to be due under or by virtue of its Statutes, viz., Chapter 290 of the Laws of 1941 and Chapter 241 of the Laws of 1942, with which Statutes the undersigned Trustees of the Debtor have duly complied pursuant to orders of this Bankruptcy Court.

2. The principal amount of taxes claimed, plus the taxes for the year 1940, plus all of the interest prescribed by the aforesaid Statutes, was paid upon the terms and in the manner prescribed by said Statutes.

3. Alternatively, upon the hypotheses stated in paragraph 5 of part "A", *supra*, the allegations of paragraphs 6, 7 and 9(a), (c) and (d) thereof are hereby repeated and the Trustees, "Objections to Proof of Claim No. 37" filed February 27, 1941 are hereby incorporated herein by reference thereto.

4. No balance is due the State under Claim No. 37.

Shelton Pitney, Walter P. Gardner, Trustees of The Central Railroad Company of New Jersey.
Shelton Pitney, of Counsel.

[fol. 115] —In United States District Court

Reply of State of New Jersey to "Supplemental and Amended Objections and Defenses of Debtor's Trustees to Claims Filed by the State of New Jersey."

The reply of the State of New Jersey to the "Supplemental and Amended Objections and Defenses of Debtor's Trustees to Claims filed by the State of New Jersey for unpaid taxes levied by the State of New Jersey," upon the property and franchises of the Debtor, and the several subsidiaries and affiliated companies whose properties and franchises are in the possession of, and are operated by, said Trustees as part of the Debtor's railroad in New Jersey, and for statutory interest accrued thereon, respectfully shows:

A. As to Claim No. 38 for $19,849,790.21

(The Central Railroad Company of New Jersey)

1. The Company against which the taxes in question were levied is a railroad corporation organized and existing under and by virtue of the Laws of the State of New Jersey; its property and francise in New Jersey were taxable for the support of the government of said State and the municipal subdivisions thereof in which said property is located, under the provisions of an act of the Legislature of said State entitled, "An Act to revise and amend 'An Act for the taxation of railroad and canal property,' approved April tenth, one thousand eight hundred and eighty-four," approved March 27, 1888 (N. J. P. L. 1888, ch. CCVIII, p. 269), and the various amendments and supplements thereof, subsequently incorporated in Chapters 19 to 29, inclusive, of Title 54 of the Revised Statutes; said property and franchise were duly and lawfully assessed for taxes, in accordance with the Constitution and Laws of [fol. 116] New Jersey, for each of the years of 1932 to 1939, inclusive, and the taxes in question were duly and lawfully levied thereon for those years in the amounts shown upon Schedule "A" attached hereto and made a part hereof. All such taxes are subject to the provision that if the taxes of any railroad company or any portion of such taxes shall remain unpaid on December 1st, following the levying thereof, the company shall be considered to be in default and such taxes or the unpaid portion thereof shall thence-

forth bear interest at the rate of one per cent each month until paid notwithstanding the prosecution of a writ of certiorari or other remedy. A substantial portion of the taxes for each of the above-mentioned years remains unpaid, and, with accrued interest, constitutes the tax debt of the company. Payments were made from time to time by the Railroad Company, as shown upon the said Schedule "A", upon the said tax debt.

2. All of the above-mentioned acts provide that taxes so levied shall be liens paramount to all other liens upon the lands tangible property and franchise of the company against which they are levied, effective on the 1st day of June of the calendar year in which said taxes are payable (R. S. 54:27-4); that if any portion of such taxes shall remain unpaid on the 1st day of December following the levying thereof, such company shall be considered in default, and such taxes, or the unpaid portion thereof, shall thenceforth bear interest at the rate of one per cent for each month until paid (Id.). Under said acts the said liens cover the entire tax debt of the Company.

3. On October 30, 1939, the date when the present proceedings were instituted, it was provided by R. S. 54:28-1 et seq. that, if a tax levied and assessed under the provisions of Chapters 19 to 29 of Title 54 of the Revised Stat- [fol. 117] utes should remain unpaid in whole or in part for ten days after the expiration of the time limited for the payment thereof, the Attorney-General should apply forthwith to a Justice of the Supreme Court for an order that the tax, together with the interest due thereon and a reasonable sum to be certified by the Justice to be paid for the expense of the proceeding, should be made a record of the Supreme Court; that judgment should be entered therefor in the name of the State as plaintiff against the company and the mortgagee or other creditor as defendants, and thereafter that execution of said judgment by the sale of the property of the company should take place, as more particularly specified by said statute.

4. When the present proceedings were instituted, the Bankruptcy Court took jurisdiction of the property and franchise of the Debtor subject to the lien of the State for the tax debt of the Debtor. The Legislature having provided specifically and exclusively the method by which the

said tax debt lien might be enforced or otherwise litigated, when the Honorable Frank J. Murray, the Comptroller of the State, did, on December 10, 1940, file, upon a form prepared and presented under the direction of the Trustees, a proof of claim for taxes and interest due and owing to the State of New Jersey, such claim must be deemed to have been presented . . r the purpose only of protecting the interest of the State in and to any funds or other assets of the Debtor upon which the State had no lien and which might be available for distribution to unsecured creditors who are given certain priorities under Section 64 of the Bankruptcy Act (Title 11, U. S. C. A., Sec. 104) in the event that the lands, tangible property and franchise, upon which the State has a statutory lien, might be insufficient to pay in full the tax debt of the Debtor to the State of New Jersey. The said proof of claim notified the Trustees and the Bank-
[fol. 118] ruptcy Court of the State's tax debt lien and the provisions of law with reference thereto.

5. Neither the Comptroller of the State of New Jersey nor any other officer of the State government has been authorized by law to waive the State's immunity from suit or to submit the rights of the State under its tax debt liens to an adjudication or enforcement by a federal court or by any other court except in the manner specifically provided in paragraph three above. Neither the Comptroller nor any other officer of the State government has been authorized to make the State a claimant in these proceedings with respect to any amount which the State may be able to realize by virtue of a sale to enforce its said lien upon the lands, tangible property and franchise of the Debtor in the State of New Jersey.

6. The Bankruptcy Court has not had jurisdiction of, and does not now have jurisdiction of the property rights of the State in and to the property and franchise of the Debtor as represented by its said liens for taxes and interest. The Honorable Homer C. Zink, presently Comptroller of the State and its Commissioner of Taxation and Finance, disavows any intention of submitting to the Bankruptcy Court jurisdiction over any property right and interest which the State may have arising out of its tax debt lien in and upon the property and franchise of the Debtor which was vested at the time of the institution of these proceedings. The said

Comptroller further shows that he is wholly without authority to submit the property rights represented by the State's tax debt liens to the jurisdiction of the Bankruptcy Court and that such lien claims, if not paid, must be satisfied by the sale of the security afforded by the said lands, tangible property and franchise in the manner provided by law. By filing this reply to the "Supplemental and Amended [fol. 119] Objections and Defenses of Debtor's Trustees, etc." the said Comptroller asserts only an interest in those assets of the Debtor, if any, upon which the State has no lien interest and which may be distributed to unsecured creditors under Section 64 of the Bankruptcy Act or otherwise. Such claim is intended to be operative only in the event that the above-mentioned security is insufficient to satisfy the whole of the tax debt, including taxes and interest, and only in the amount that the tax debt due to the State may exceed such amount as may be realized by a sale of the security under the provision of the statute.

7. The said Comptroller is not presently in a position even to approximate the amount of the claim which the State may have to make, if any, against the unsecured assets of the Debtor under the said Section 64 of the Bankruptcy Act or otherwise, because the Attorney-General, who alone is authorized to enforce the State's tax debt liens, is presently enjoined by order of the Bankruptcy Court from performing his statutory duty in said regard.

8. The said Comptroller asserts that the proof of claim, reply to Trustees' objections, and this present reply to the said supplemental and amended objections, are for the purpose of notifying the Trustees that there is a lien interest of the State of New Jersey which is beyond the jurisdiction of the Court, since the Trustees took the property subject to all tax debt liens of the State, and which no officer of the State is authorized to bring within such jurisdiction, and for the further purpose of laying the basis for making a specific claim for any amount by which any sale of the property subject to the State's liens shall be deficient in satisfying the full tax debt, at such later date as the Court may permit such a sale under the New Jersey statute.

[fol. 120] 9. By way of information to the Trustees and to the Court, and subject to what has been stated hereinabove

as to the nature of this and the prior Claim No. 38, it is respectfully shown as follows:

Crediting the payments aforesaid, as shown in Schedule "A" hereof, first to interest then accrued, and the excess, if any, to principal taxes for each year for which such payments were made, there result balances of principal and interest, as of September 1, 1944, for each year from 1932 to 1939, inclusive, as follows:

Year	Tax	Interest	Total Tax Debt
1932	$2,228,774.18	$2,157,914.03	$4,386,688.21
1933	2,220,889.44	2,444,435.37	4,665,324.81
1934	1,813,404.60	1,864,139.64	3,677,544.24
1935	1,762,784.78	1,616,715.17	3,379,499.95
1936	1,646,434.71	1,526,835.79	3,173,270.50
1937	1,438,694.32	1,161,512.50	2,600,206.82
1938	1,508,844.94	1,040,632.35	2,549,477.29
*1939	1,521,060.56	813,988.65	2,335,049.21
Totals	$14,140,887.53	$12,626,173.50	$26,767,061.03

* Includes additional taxes assessed by State Board of Tax Appeals Judgment of May 26, 1942, together with additional interest from date of certification thereof, August 27, 1942.

Additional interest will become due on the principal sums shown until payment.

Nothing hereinabove contained shall be taken as a waiver of the tax debt of the Company for the year 1940, or of the liability of the Trustees to the State for tax debts accrued since the commencement of these bankruptcy proceedings, as administration expenses.

10. In the alternative to the qualified statement of claim contained in paragraphs one to nine herein, and in the event that it shall be finally determined judicially that the Bankruptcy Court has jurisdiction to adjudicate the amount of [fol. 121] tax debt liens of the State notwithstanding the failure of the State to consent thereto, the State herewith asserts its statutory lien in the full amount of the tax debts as shown in paragraph nine hereinabove, including the additional interest, as stated therein.

Particularly replying to the specific allegations contained in paragraphs one to ten, inclusive, of the Trustees' "Sup-

plemental and Amended Objections and Defenses of Debtor's Trustees to Claims Filed by the State of New Jersey":

11. The allegations contained in paragraphs one to five, inclusive, are denied.

12. Chapter 290 of the Laws of 1941 and Chapter 241 of the Laws of 1942 were in violation of Article I, paragraph 20 of the Constitution of New Jersey, and were null and void from their enactment. They conferred no rights, privileges, immunities or equities upon the Debtor and the Trustees as against the State of New Jersey.

13. Chapter 290 of the Laws of 1941 and Chapter 241 of the Laws of 1942 were in violation of Article IV, Section 7, paragraph 11 of the Constitution of New Jersey, and were null and void from the respective dates of their enactment.

14. Chapter 290 of the Laws of 1941 and Chapter 241 of the Laws of 1942 have been finally decreed to be in contravention of Article I, paragraph 20 of the Constitution of New Jersey and null and void by the Court of Chancery of New Jersey and such decree has been affirmed by the Court of Errors and Appeals of New Jersey. Such adjudications by State courts as to the nullity of a State statute under the Constitution of the State are of binding force in [fol. 122] courts of the United States and may not be attacked, set aside, impeached, or qualified in collateral proceedings in courts of the United States.

15. Chapter 290 of the Laws of 1941 and Chapter 241 of the Laws of 1942 purported to create settlement machinery under which railroad taxpayers, including the Trustees herein might make certain tenders and the State Treasurer of New Jersey was authorized, required and directed to take specific affirmative actions to consummate the tenders and complete the accord between the taxpayer and the State. Such consummation and completed accord never has taken place, the said State Treasurer having declined to accept the various documents and payments tendered, or to collect or deposit into the Treasury of the State of New Jersey any moneys or checks tendered, all in obedience to orders of restraint entered in the New Jersey Court of Chancery, and to a final decree entered in that Court, sub-

sequently affirmed by the Court of Errors and Appeals, adjudicating said acts to be null and void. The Trustees herein cannot, by collateral action in a court of the United States, compel the effectuation of an accord by the State of New Jersey which, in fact, has not taken place, and which, under the final decree of New Jersey courts of competent jurisdiction, can never lawfully take place.

16. The Debtor and the Trustees failed to comply with the conditions of Chapter 241 of the Laws of 1942 in that the acceptance document filed by and on behalf of the Debtor and the Trustees does not provide for the payment in full of the principal amount of all of its unpaid taxes for the tax years 1932-1940, inclusive, but, on the contrary, for a lesser amount or amounts. The deficiency in the amount agreed to be paid by said acceptance document arises by virtue of (a) erroneous computation by the Trustees and [fol. 123] the Debtor of the amounts of principal taxes due, on the basis of allocating prior partial payments to principal and not to interest, whereas, as a matter of law said payments were allocable first to interest; (b) failure to include in the said principal sum for the tax year 1939 the amount of increase in 1939 taxes payable by the Debtor by virtue of a judgment of the State Board of Tax Appeals dated May 26, 1942.

17. The allegations contained in paragraph six are denied except that it is admitted that other than Class II railroad property was taxed at an "average tax rate," as provided by law and that Class II railroad property was taxed at local tax rates. The legal objections to the "average tax rate," as set forth in said paragraph six, were determined adversely to the Debtor by the Supreme Court of New Jersey in *Central Railroad Company of New Jersey* vs. *State Board of Tax Appeals*, 109 N. J. L. 395, and by the Court of Errors and Appeals of New Jersey in *Central Railroad Company of New Jersey* vs. *State Tax Department*, 112 N. J. L. 5, and said objections are therefore res adjudicata.

18. Paragraph seven is denied.

19. Paragraph eight is denied except that it is admitted that the State received the sum of $239,749.80 as payment on account of franchise taxes due from the Debtor to the State for the tax year 1941 under the Railroad Tax Law of 1941, as amended by Chapter 169 of the Laws of 1942.

20. Paragraphs nine and ten are denied.

21. Further answering paragraphs nine and ten, the State has a statutory lien upon the lands, tangible property and franchise of the Debtor within the State of New [fol. 124] Jersey, but the question of liens cannot be determined or adjudicated by the Bankruptcy Court because the State has not consented to any such adjudication.

22. Further answering paragraphs five to ten, inclusive, each of the assessments made by the assessing authorities of New Jersey for the years 1932-1939, inclusive, upon property of the Debtor, have been litigated by the Debtor in tribunals of appropriate jurisdiction and all of such litigations have resulted in affirmance of the assessments except that upon appeal by the City of Jersey City to the State Board of Tax Appeals the assessed valuation of property of the Debtor for the year 1939 was increased. All objections by the Debtor in law or in fact to any of the said assessments are thus res adjudicata, and the full amount of statutory interest at the rate of one per cent per month is due upon all arrearages in taxes assessed. The litigation aforementioned was as follows:

(a) *1932 taxes (State Board of Tax Appeals).* A petition of appeal by the Debtor was dismissed by the State Board of Tax Appeals and the assessment affirmed, after hearing. No opinion was filed by the Board but the grounds of decision are stated in the opinion of the Board disposing of the appeal for the year 1933. See New Jersey Tax Reports, 1912-1934, at p. 680. No application for review of this judgment by certiorari was made by Debtor.

(b) *1933 taxes.* A petition of appeal filed by Debtor was heard by the State Board of Tax Appeals and the assessments were affirmed. New Jersey Tax Reports, 1912-1934, p. 675. On certiorari the New Jersey Supreme Court, on December 11, 1934, affirmed the judgment of the Board, specifically finding that the method of assessment was legal and did not result in excessive valuations; and that the Board correctly found that the proofs adduced by the rail- [fol. 125] roads did not sustain the allegations of discriminatory assessment. The opinion is reported in 114 N. J. L. 69. No appeal was taken from this judgment.

(c) *1932-1933 federal cases.* The Debtor and other railroad companies brought suit in the United States District Court of New Jersey for a permanent injunction against the collection by the New Jersey authorities of taxes assessed for the years 1932 and 1933. By stipulation the case was argued on the testimony taken before the State Board in the 1933 case. The contentions of the railroads were that their properties were excessively valued by the use of improper principles which resulted in the denial of due process and which subjected interstate commerce to an undue burden, and that they were discriminated against in that their properties were assessed at full value while other property in the State was assessed at less than full value, resulting in denial of equal protection of the laws. The District Court dismissed the application for both procedural and meritorious reasons. The Court held the evidence adduced did not establish the charges made. The opinion is reported in 19 Fed. Supp. 63, decided December 14, 1936.

On appeal the judgment was affirmed by the United States Circuit Court of Appeals for the Third Circuit. The opinion is reported in 100 Fed. (2d) 139, decided November 15, 1938. The Circuit Court held: (1) The contentions made were not established by the proof adduced; (2) the federal Court had no jurisdiction to interfere with the collection of these taxes, under the Federal Judicial Code, Sec. 263; (3) the issues raised on the merits were res adjudicata by reason of their determination by the New Jersey Supreme Court in the 1933 case reported in 114 N. J. L. 69. Application for certiorari was denied by the United States Supreme Court on April 19, 1939. (306 U. S. 651, rehearing denied 306 U. S. 669.)

[fol. 126] (d) *1934 taxes.* The Debtor and other railroad companies appealed from assessments of railroad property for the year 1934, made by the State Tax Commissioner, to the State Board of Tax Appeals, urging: (1) The properties were assessed in excess of their true value; (2) the method of valuing was erroneous and improper; (3) discriminatory assessment of railroad property.

Proof was adduced by the petitioners with respect to all three issues. The petitioners produced 54 witnesses as to underassessment of non-railroad property, and presented 53 exhibits containing appraisals of 20,000 parcels of real

estate made in 104 of the 563 taxing districts in the State. The Board found that the great mass of property in the State was not undervalued and that there was not any general, systematic, or intentional undervaluation of property generally, or any discrimination in assessing railroad property. The assessments were affirmed. The opinion is reported in New Jersey Tax Reports, 1934-1939, page 82, decided on July 23, 1935. No review of this judgment was sought in the New Jersey Supreme Court by any of the petitioning railroads.

(e) *1935 taxes.* Petitions of appeal were filed by the Debtor and other railroad companies with the State Board of Tax Appeals from the assessments of railroad property for the year 1935. The issues raised were identical with those in the 1934 case. The assessments were affirmed by the Board on the authority of the Supreme Court judgment in the 1933 tax case, 114 N. J. L. 69. The opinion of the Board is reported in New Jersey Tax Reports, 1934-1939, page 233, decided on May 5, 1936. No review of this judgment was sought in the New Jersey Supreme Court by any of the petitioning railroads.

(f) *1936 taxes.* Appeals were filed by the Debtor and other railroad companies from assessments for the year [fol. 127] 1936 made by the State Tax Commissioner, upon the same grounds as those urged in the 1934 and 1935 appeals. Hearings were held and testimony was adduced by the railroads upon all the issues presented. The appeals were dismissed by the Board and the assessments were affirmed. No written opinion was rendered. No review of this judgment was sought in the New Jersey Supreme Court by any of the petitioning railroads.

(g) *1934, 1935 and 1936 federal cases.* Suits were brought in the United States District Court of New Jersey by the Debtor and other railroad companies to enjoin the collection of railroad taxes for the years 1934 to 1936, inclusive, by the New Jersey authorities. The railroad companies contended: (1) Railroad lands were valued individually, according to the market value of adjacent lands not used for railroad purposes; (2) railroad structures were individually valued on the basis of cost of reproduction less depreciation; (3) railroad equipment was valued at reproduction cost less depreciation; (4) the franchise valua-

tion was an estimate based on no definite figures; (5) earnings of the railroads were not reflected in the valuations; (6) taxes were not computed upon true values of the property; (7) the valuations were excessive, discriminatory, and violative of the due process and equal protection clauses of the Federal Constitution; (8) the assessments imposed an undue burden upon interstate commerce; (9) the railroads were not valued as such, or as New Jersey divisions of systems to which they belong, and no attempt was made to value with reference to earnings of systems or to the value of the stocks and bonds of the railroads.

Extensive proofs were adduced, occupying a period of several months. The assessments for the years 1934 to 1936, inclusive, were tried as a unit. The District Court sustained all the contentions made by the railroads, except [fol. 128] the charge of discriminatory assessment, which it found not to be established by the evidence. The court enjoined the collection by the New Jersey authorities of more than 60% of the 1934, 1935 and 1936 assessments until a revaluation of the properties should be made by such authorities in conformity with the opinion of the court. The opinion of the court is reported in 30 Fed. Supp. 41, decided November 1, 1939. On January 20, 1940, the injunction was modified to 70%.

Upon appeal, the judgment of the District Court was reversed by the United States Third Circuit Court of Appeals. The opinion is reported in 115 Fed. (2d) 968, decided November 27, 1940. The Circuit Court held that the evidence did not establish the deprivation of any rights of the railroads under the United States Constitution, and that all questions as to the validity of the method of assessment of railroad property in New Jersey were res adjudicata by virtue of the judgments of the New Jersey Supreme Court in respect thereto, in the appeals of the 1933 assessments, reported 114 N. J. L. 69. Certiorari was denied by the United States Supreme Court on April 28, 1941. (313 U. S. 568.)

(h) *1937-1938 taxes (State Board of Tax Appeals).* Appeals were filed for the years 1937 and 1938 by the Debtor and other railroad companies from the assessments made by the State Tax Commissioner. The petition of appeal of the Debtor alleged the following: (1) The assessments were

in excess of true value; (2) errors in method of valuation as charged in prior appeals; (3) assessments were arbitrary and grossly excessive, constituting a deprivation of property without due process of law, in violation of the Fourteenth Amendment to the Federal Constitution; (4) petitioners' property was assessed in excess of true value, while other than railroad property generally was intentionally [fol. 129] and system-ically assessed at less than true value, thus constituting a denial of equal protection of the laws in violation of Article IV, Section 7, paragraph 12, of the New Jersey Constitution; (5) petitioners' assessments were intentionally and systematically made at a different and higher percentage of true value than those of other than railroad property generally throughout the State, thus constituting denial of equal protection of the laws in violation of the Fourteenth Amendment to the Federal Constitution; (6) the taxes were excessive, unlawful, and unconstitutional, because based upon excessive assessments; the average tax rate, applied to main stem (Class I), tangible personal property (Class III), and franchise (Class IV), was in excess of a lawful rate and higher than if other than railroad property generally throughout the State, was assessed at true value, resulting in illegal discrimination and denial of equal protection of the laws in violation of the Fourteenth Amendment to the United States Constitution; (7) to the extent that they were in excess of true value, the assessments constituted an interference with and a burden upon interstate commerce in violation of Article I, Section 8, of the Federal Constitution.

The appeals for the years 1937 and 1938 were tried as a unit. Hearings were held by the Board and an aggregate of 4,610 pages of testimony were taken and 450 exhibits introduced into evidence. No testimony was adduced as to discriminatory assessment of railroad property as compared with nonrailroad property. The Board affirmed the assessments on May 13, 1941. The opinion is reported in 19 N. J. Misc. 427, 20 Atl. (2d) 330. No review of the judgment of the Board in these cases was sought.

(i) *1939 taxes (State Board of Tax Appeals).* Appeals were taken by the Debtor and other railroad companies from assessments made by the State Tax Commissioner to [fol. 130] the State Board of Tax Appeals. For the year

1939, the State Tax Commissioner made primary valuations substantially as in 1938. On petition for revision however, the Commissioner made final valuations as follows: he assessed main stem or Class I lands at the same valuations as for the year 1938, except for waterfront property. All waterfront land valuations, including the great bulk of Class II railroad property in Hudson County, were reduced uniformly 10% from the primary valuations. All improvements, or structural items, on Class II railroad property, were reduced uniformly 7½% from the primary valuations. All construction items, including grading on the main stem, were reduced uniformly 20% from the primary valuations. The City of Jersey City filed appeals to the State Board of Tax Appeals, seeking to restore the reductions in assessments of Class II property in that taxing district.

Testimony was introduced at length on behalf of the railroads, except as to discriminatory assessment of railroad property, as to which there was no testimony adduced. Testimony was adduced by the State in rebuttal of the proofs of the railroads, by the City of Jersey City in support of its appeal, and by the railroads in opposition to said appeal. The Board, on May 26, 1942, rendered judgment on the appeal of the City of Jersey City, restoring the primary valuations fixed for the year 1939. The opinion of the Board is reported in 20 N. J. Misc. 283, 26 Atl. (2d) 733.

The appeals of the railroad companies were dismissed, without opinion, by judgments dated June 2, 1942. No review of said judgment was sought in the State Courts by the Debtor or the Trustees. By Order No. 171 the Bankruptcy Court reversed and set aside the said judgment of May 26, 1942, as to the Debtor and Trustees. On appeal by the State and the City of Jersey City, the said Order No. 171 was reversed and set aside by the United States Circuit Court of Appeals for the Third Circuit. 136 F. (2d) 633 (C. C. A. 3d 1943).

[fol. 131] 23. There is repeated herewith all of the allegations contained in the "Reply of Claimant, State of New Jersey, to Trustees' Objections to Tax Claims," filed March 26, 1941, insofar as such allegations are not inconsistent with anything contained herein.

B. As to Claim No. 34 for $10,369.88

(Ogden Mine Railroad Company)

1. There is repeated each and every allegation contained in paragraphs one to eight, inclusive, of "A" hereinabove.

2. By way of information to the Trustees and to the Court, and subject to what has been stated hereinabove as to the nature of this and the prior Claim No. 34, it is respectfully shown as follows:

Crediting the payments aforesaid, as shown in Schedule "A" hereof, first to interest then accrued, and the excess, if any, to principal taxes for each tax year for which such payments were made, there result balances of principal and interest, as of September 1, 1944, for each year from 1933 to 1939, inclusive, as follows:

Year	*Tax*	*Interest*	*Total Tax Debt*
1933	$3,279.83	$ 903.96	$4,183.79
1934	2,649.71	2,729.07	5,378.78
1935	643.53	591.58	1,235.11
1936	631.96	587.53	1,219.49
1937	583.22	472.23	1,055.45
1938	623.26	429.86	1,053.12
1939	579.10	315.22	894.32
Totals	$8,990.61	$6,029.45	$15,020.06

Additional interest will become due on the principal sums shown until payment.

[fol. 132] Nothing hereinabove contained shall be taken as a waiver of the tax debt of the Company for the year 1940, or of the liability of the Trustees to the State for tax debts accrued since the commencement of these bankruptcy proceedings, as administration expenses.

3. In the alternative to the qualified Statement of Claim contained in paragraphs one and two herein, and in the event that it shall be finally determined judicially that the Bankruptcy Court has jurisdiction to adjudicate the amount of tax debt liens of the State notwithstanding the failure of the State to consent thereto, the State herewith makes

claim for such liens in full amount of the sums shown in paragraph two hereinabove, with interest as stated.

Particularly replying to the specific allegations contained in paragraphs one to four, inclusive, of the "Trustees' Supplemental and Amended Objections and Defenses of Debtor's Trustees to Claims filed by the State of New Jersey":

4. The allegations contained in paragraphs one to four, inclusive, are denied except as to such admitted portions of paragraph- six and seven of part A of Supplemental and Amended Objections which are incorporated by reference.

5. There is repeated herewith each of the allegations contained in paragraphs twelve to twenty-three of "A" hereinabove.

C. As to Claim No. 35 for $458,800.35

(New York and Long Branch Railroad Company)

1. There is repeated each and every allegation contained in paragraphs one to eight, inclusive, of "A" hereinabove.

[fol. 133] 2. By way of information to the Trustees and to the Court, and subject to what has been stated hereinabove as to the nature of this and the prior Claim No. 35, it is respectfully shown as follows:

Crediting the payments aforesaid, as shown in Schedule "A" hereof, first to interest then accrued, and the excess, if any, to principal taxes for each tax year for which such payments were made, there result balances of principal and interest, as of September 1, 1944, for each year from 1934 to 1939, inclusive, as follows:

Year	*Tax*	*Interest*	*Total Tax Debt*
1934	$52,453.87	$61,354.66	$113,808.53
1935	51,240.26	53,786.29	105,026.55
1936	52,504.31	48,812.63	101,316.94
1937	85,470.19	69,204.20	154,674.39
1938	45,727.08	31,537.42	77,264.50
1939	33,200.19	17,972.30	51,172.49
Totals	$320,595.90	$282,667.50	$603,263.40

Additional interest will become due on the principal sums shown until payment.

Nothing hereinabove contained shall be taken as a waiver of the tax debt of the Company for the year 1940, or of the liability of the Trustees to the State for tax debts accrued since the commencement of these bankruptcy proceedings, as administration expenses.

3. In the alternative to the qualified Statement of Claim contained in paragraphs one and two herein, and in the event that it shall be finally determined judicially that the Bankruptcy Court has jurisdiction to adjudicate the amount of tax debt liens of the State notwithstanding the failure of the State to consent thereto, the State herewith makes claim for such liens in full amount of the sums shown in paragraph two hereinabove, with interest as stated.

[fol. 134] Particularly replying to the specific allegations contained in paragraphs one to four, inclusive, of the "Trustees' Supplemental and Amended Objections and Defenses of Debtor's Trustees to Claims filed by the State of New Jersey":

4. The allegations contained in paragraphs one to four, inclusive, are denied except as to such admitted portions of paragraphs six and seven of part A of Supplemental and Amended Objections which are incorporated by reference.

5. There is repeated herewith each of the allegations contained in paragraphs twelve to twenty-three of "A" hereinabove.

D. As to Claim No. 36 for $22,939.09

(Dover and Rockaway Railroad Company)

1. There is repeated each and every allegation contained in paragraphs one to eight, inclusive, of "A" hereinabove.

2. By way of information to the Trustees and to the Court, and subject to what has been stated hereinabove as to the nature of this and the prior Claim No. 36, it is respectfully shown as follows:

Crediting the payments aforesaid, as shown in Schedule "A" hereof, first to interest then accrued, and the excess, if any, to principal taxes for each tax year for which such payments were made, there result balances of principal and

interest, as of September 1, 1944, for each year from 1933 to 1939, inclusive, as follows:

[fol. 135]

Year	*Tax*	*Interest*	*Total Tax Debt*
1933	$4,375.99	$1,201.32	$5,577.31
1934	3,010.65	3,100.81	6,111.46
1935	3,033.57	2,788.52	5,822.09
1936	2,380.73	2,213.33	4,594.06
1937	2,224.54	1,801.18	4,025.72
1938	2,025.96	1,397.29	3,423.25
1939	1,894.65	1,031.32	2,925.97
Totals	$18,946.09	$13,533.77	$32,479.86

Additional interest will become due on the principal sums shown until payment.

Nothing hereinabove contained shall be taken as a waiver of the tax debt of the Company for the year 1940, or of the liability of the Trustees to the State for tax debts accrued since the commencement of these bankruptcy proceedings, as administration expenses.

3. In the alternative to the qualified Statement of Claim contained in paragraphs one and two herein, and in the event that it shall be finally determined judicially that the Bankruptcy Court has jurisdiction to adjudicate the amount of tax debt liens of the State notwithstanding the failure of the State to consent thereto, the State herewith makes claim for such liens in full amount of the sums shown in paragraph two hereinabove, with interest as stated.

Particulary replying to the specific allegations contained in paragraphs one to four, inclusive, of the "Trustees' Supplemental and Amended Objections and Defenses of Debtor's Trustees to Claims filed by the State of New Jersey":

4. The allegations contained in paragraphs one to four, inclusive, are denied except as to such admitted portions of paragraphs six and seven of Supplemental and Amended Objections which are incorporated by reference.

[fol. 136] 5. There is repeated herewith each of the allegations contained in paragraphs twelve to twenty-three of "A" hereinabove.

E. As to Claim No. 37 for $9,129.90

(Bay Shore Connecting Railroad Company)

1. Substantial payments have been made against this account by the Lehigh Valley Railroad Company. The exact relationship of the companies is not known.

2. There is repeated each and every allegation contained in paragraphs two to eight, inclusive, of "A" hereinabove.

3. By way of information to the Trustees and to the Court, and subject to what has been stated hereinabove as to the nature of this and the prior Claim No. 37, it is respectfully shown as follows:

Crediting the payments heretofore made first to interest then accrued, and the excess, if any, to principal taxes for each tax year for which such payments were made, there result balances of principal and interest, as of September 1, 1944, for each year from 1933 to 1939, inclusive, as follows:

Year	*Tax*	*Interest*	*Total Tax Debt*
1933	$946.23	$515.05	$1,461.28
1934	1,295.77	279.25	1,575.02
1935	1,109.63	108.10	1,217.73
1936	1,002.92	15.85	1,018.77
1937	762.91	12.05	774.96
1938	775.98	12.26	788.24
1939	581.37	9.19	590.56
Totals	$6,474.81	$951.75	$7,426.56

Additional interest will become due on the principal sums shown until payment.

[fol. 137] Nothing hereinabove contained shall be taken as a waiver of the tax debt of the Company for the year 1940, or of the liability of the Trustees to the State for tax debts accrued since the commencement of these bankruptcy proceedings, as administration expenses.

4. In the alternative to the qualified Statement of Claim contained in the paragraphs herein, and in the event that it shall be finally determined judicially that the Bankruptcy Court has jurisdiction to adjudicate the amount of tax debt liens of the State notwithstanding the failure of the

State to consent thereto, the State herewith makes claim for such liens in full amount of the sums shown in paragraph three hereinabove, with interest as stated.

Particularly replying to the specific allegations contained in paragraphs one to ten, inclusive of the "Trustees' Supplemental and Amended Objections and Defenses of Debtor's Trustees to Claims filed by the State of New Jersey":

5. The allegations contained in paragraphs one to four, inclusive, are denied except as to such admitted portions of paragraphs six and seven of Supplemental and Amended Objections which are incorporated by reference.

6. There is repeated herewith each of the allegations contained in paragraphs twelve to twenty-three of "A" hereinabove.

Respectfully, (Signed) Walter D. Van Riper, Attorney-General of the State of New Jersey, Attorney for the State of New Jersey, State House, Trenton, N. J.

Dated: December 12, 1944.

[fol. 138]

SCHEDULE A—SHEET 1

CENTRAL RAILROAD OF NEW JERSEY SYSTEM
CENTRAL RAILROAD OF NEW JERSEY

Date of Levy	First Class			Second Class		
	Amount of Levy	Date of Payment	Amount of Payment	Amount of Levy	Date of Payment	Amount of Payment
1932	$2,372,866.16	12- 1-32	$720,000.00	$1,775,908.02	12- 1-32	$1,200,000.00
		3-12-37	154,387.09		9-30-38	3,779.77
		7- 3-40	108,553.59		7-30-40	41,446.41
		8- 2-40	108,553.58		8- 2-40	41,446.42
		9- 4-40	108,553.59		9- 4-40	41,446.41
		10- 3-40	108,553.59		10- 3-40	41,446.41
		11- 7-40	108,553.59		11- 7-40	41,446.41
		12- 2-40	75,975.07			
1933	2,145,190.95	12- 1-33	901,975.72	1,683,486.25	12- 1-33	705,812.04
		3-12-37	170,619.76		3-12-37	135,931.08
		12- 2-40	41,601.03		9-30-38	5,760.96
					12- 2-40	32,423.90
1934	2,126,613.77	12- 1-34	1,137,787.28	1,773,373.98	12- 1-34	948,795.87
		1-28-37	138,180.98		1-28-37	115,228.52
					9-30-38	3,586.32
1935	1,987,943.48	12- 1-35	1,073,489.48	1,844,197.34	12- 1-35	995,866.56
		1-28-37	119,276.61		1-28-37	110,651.84
					9-30-38	3,730.54
1936	1,959,791.36	12- 1-36	1,097,483.16	1,782,105.70	12- 1-36	997,979.19
					9-30-38	4,082.44
1937	1,874,577.67	12- 1-37	1,124,746.61	1,722,258.28	12- 1-37	1,033,395.02
					9-30-38	3,595.94
1938	1,932,529.53	12- 1-38	1,159,517.71	1,849,582.20	9-30-38	9,999.39
					12- 2-38	1,103,749.69
1939	1,706,740.27	12-27-39	1,024,044.16	*1,835,224.18	12-27-39	1,025,509.07

* Includes additional taxes assessed by State Board of Tax Appeals by judgment of May 26, 1942.

[fol. 139]

SCHEDULE A—SHEET 2

CENTRAL RAILROAD OF NEW JERSEY SYSTEM
OGDEN MINE RAILROAD CO.

Date of Levy	First Class			Second Class		
	Amount of Levy	Date of Payment	Amount of Payment	Amount of Levy	Date of Payment	Amount of Payment
1933	$5,240.50	12- 1-33	$2,196.62	$577.87	12- 1-33	$342.02
		3-12-37	370.60			
		2-19-40	2,673.38		2-19-40	235.85
1934	5,144.23	12- 1-34	2,752.28	554.36	12- 1-34	296.60
		1-28-37	334.26		1-28-37	36.01
1935	1,126.75	12- 1-35	608.45	272.25	12- 1-35	147.02
		1-28-37	67.60		1-28-37	16.33
1936	1,170.73	12- 1-36	655.61	265.55	12- 1-36	148.71
1937	1,190.18	12- 1-37	714.10	267.86	12- 1-37	160.72
1938	1,278.42	12- 1-38	767.05	279.73	12- 1-38	167.84
1939	1,119.82	2-19-40	665.89	248.20	2-19-40	148.92

[fol. 140]

SCHEDULE A—SHEET 3

CENTRAL RAILROAD OF NEW JERSEY SYSTEM
NEW YORK AND LONG BRANCH RAILROAD CO.

Date of Levy	First Class			Second Class		
	Amount of Levy	Date of Payment	Amount of Payment	Amount of Levy	Date of Payment	Amount of Payment
1934	$166,722.86	12- 1-34	$125,042.15	$43,092.62	12- 1-34	$32,319.46
1935	161,653.31	12- 1-35	121,239.98	43,307.73	12- 1-35	32,480.80
1936	166,633.27	12- 1-36	124,974.95	43,383.96	12- 1-36	32,537.97
1937	169,450.77	12- 1-37	101,670.46	44,224.71	12- 1-37	26,534.83
1938	147,010.00	12- 1-38	110,257.50	35,898.31	12- 1-38	26,923.73
1939	120,037.44	12- 1-39	60,018.72	34,509.92	12- 1-39	17,254.96
		2-28-40	36,011.14		2-28-40	10,352.95

[fol. 141]

SCHEDULE A—SHEET 4

CENTRAL RAILROAD OF NEW JERSEY SYSTEM
DOVER AND ROCKAWAY RAILROAD CO.

Date of Levy	First Class			Second Class		
	Amount of Levy	Date of Payment	Amount of Payment	Amount of Levy	Date of Payment	Amount of Payment
1933	$5,724.48	12- 1-33	$2,399.71	$1,506.27	12- 1-33	$455.05
		3-12-37	462.52		3-12-37	298.09
		2-19-40	2,862.25		2-19-40	753.13
1934	5,529.85	12- 1-34	2,958.60	944.99	12- 1-34	505.59
		1-28-37	359.31		1-28-37	61.40
1935	5,570.26	12- 1-35	3,007.94	1,024.45	12- 1-35	553.20
		1-28-37	334.22		1-28-37	61.47
1936	4,651.73	12- 1-36	2,604.97	759.03	12- 1-36	425.06
1937	4,729.02	12- 1-37	2,837.41	832.33	12- 1-37	499.40
1938	4,369.97	12- 1-38	2,621.98	694.93	12- 1-38	416.96
1939	3,827.90	2-19-40	2,296.74	615.16	2-19-40	369.10

[fol. 142] STATE OF NEW JERSEY,
County of Mercer, ss:

Homer C. Zink, of full age, being duly sworn according to law on his oath says:

1. I am Comptroller of the Treasury of the State of New Jersey and Commissioner of Taxation and Finance of the State of New Jersey.

2. I have read the foregoing "Reply of State of New Jersey to 'Supplemental and Amended Objections and Defenses of Debtor's Trustees to Claims Filed by the State of New Jersey'" and the facts set forth therein are true to the best of my knowledge, information and belief.

3. The said "Reply of State of New Jersey to 'Supplemental and Amended Objections and Defenses of Debtor's Trustees to Claims filed by the State of New Jersey'" truly sets forth the position I officially take as said Comptroller of the Treasury of New Jersey and Commissioner of Taxation and Finance of the State of New Jersey with respect to the tax debt of the Central Railroad Company of New Jersey to the State of New Jersey.

(Signed) Homer C. Zink.

Sworn and subscribed before me this 12th day of December, A. D. 1944. (Signed) C. Lillain Ayres, Notary Public of New Jersey.

[fol. 143] IN UNITED STATES DISTRICT COURT

OBJECTIONS OF INSTITUTIONAL GROUP AND THE TRUSTEE OF THE DEBTOR'S GENERAL MORTGAGE TO CLAIM NO. 38 FILED BY THE STATE OF NEW JERSEY

Now come the Institutional Group of Investors, Holders of Central Railroad Company of New Jersey Securities, and Central Hanover Bank and Trust Company, as trustee under the Debtor's General Mortgage, dated July 1, 1887, both jointly and separately, expressly reserving their rights to amend these objections, and upon information and belief

object to claim No. 38, filed herein by the State of New Jersey, on the following grounds:

1. The amount of said claim exceeds the maximum amount that the State may lawfully claim under the provisions of its statutes comprising Chapter 290 of the New Jersey Laws of 1941 and Chapter 241 of the New Jersey Laws of 1942, with which the Trustees of the Debtor have duly complied pursuant to orders of this Court.

(a) Pursuant to the provisions of said statutes, the maximum amount that the State may lawfully claim is payable only in the amounts, at the times, upon the terms and in the manner therein prescribed.

(b) The maximum amount that the State may so claim for the years 1932-1940 inclusive, is $13,438,669.19, of which the Trustees have paid $2,432,352.91 on account, leaving a balance of $11,006,316.28 to be paid as provided in said statutes.

2. Alternatively, if said statutes are finally determined to be without force and effect with respect to the trustees and the Debtor's Estate, objection is made to the allowance of any part of said claim with respect to any period subsequent to 1933, on the ground that said claim is based upon [fol. 144] the application to the Debtor's property, of tax rates which were derived from computations based upon undervaluation of other taxable property and failure to value still other taxable property, which undervaluations and omissions were in violation of the constitution and statutes of the State of New Jersey and resulted in the application of unlawful and excessive tax rates to the Debtor's property. No adequate remedy in the courts of the State of New Jersey was or is available and consequently, the effect of the use and application of said unlawful assessments and tax rates would be, unless relief were granted by this Court, to deprive these Objectors of their property without due process of law, contrary to the provisions of the Fourteenth Amendment to the Constitution of the United States.

3. (A) Said claim, in so far as it includes amounts in addition to the principal amount of the taxes alleged to be

unpaid, is not entitled to a lien equal or paramount to the lien of the Debtor's General Mortgage, for the reasons that

(i) the law of the State of New Jersey at the time of execution and delivery of the Debtor's General Mortgage made no provision for such a lien.

(ii) the law of the State of New Jersey at the time these proceedings were instituted made no provision for such a lien, and

(iii) The law of the State of New Jersey now makes no provision for such a lien,

and the imposition of such a lien, even if now authorized by the law of the State of New Jersey, would result in the impairment of contract rights of the Trustee of the Debtor's General Mortgage and in depriving these Objectors of their [fol. 145] property without due process of law, contrary to the provisions of the Fourteenth Amendment to the Constitution of the United States.

(B) The State has no lien, with respect to said claim, on the personal property of the Debtor or of the Debtor's Trustees.

4. (A) In so far as said claim includes amounts in addition to the principal amount of the taxes alleged to be unpaid, any such additional amounts that accrued while the Debtor or its Trustees were in good faith contesting the legality of the taxes included in said claim or while the collection of said taxes was enjoined by judicial decree or statute, constitute a penalty under Section 57 (j) of the Bankruptcy Act and may not be allowed.

(B) Alternatively, if any such additional amounts referred to in the preceding paragraph (A) shall be found to be allowable, objection is made to the allowance of any portion thereof with respect to the period subsequent to October 30, 1939, in excess of six per cent per annum on the principal amount of the taxes allowed, and with respect to the period subsequent to December 1, 1940, in excess of

[fol. 146] three per cent per annum on the principal amount of the taxes allowed.

Dated: November 22, 1944.

Group of Institutional Investors, Holders of Central Railroad Company of New Jersey Securities, by: (Signed: Fred N. Oliver) Fred N. Oliver; (Signed: Willard P. Scott) Willard P. Scott; (Signed: Blair Reiley) Blair Reiley, Their Attorneys. Central Hanover Bank and Trust Company, as Trustee, by: (Signed: A. M. Lewis) A. M. Lewis; (Signed: Autenreith & Wortendyke) Autenreith & Wortendyke, Its Attorneys.

Oliver & Donnally, Rathbone, Perry, Kelley & Drye, of Counsel.

[fol. 147] IN UNITED STATES DISTRICT COURT

REPLY OF STATE OF NEW JERSEY TO "OBJECTIONS OF INSTITUTIONAL GROUP AND THE TRUSTEE OF THE DEBTOR'S GENERAL MORTGAGE TO CLAIM NO. 38 FILED BY THE STATE OF NEW JERSEY

The reply of the State of New Jersey to the "Objections of Institutional Group and the Trustee of the Debtor's General Mortgage to Claim No. 38 Filed by the State of New Jersey", respectfully shows:

1. As to the allegations contained in paragraph one, it repeats each and every allegation contained in paragraphs twelve to sixteen, inclusive, of the "Reply of State of New Jersey to 'Supplemental and Amended Objections and Defenses of Debtor's Trustees to Claims Filed by the State of New Jersey'."

2. As to the allegations of fact contained in paragraphs two to four, inclusive, the facts are denied and the conclusions of law contained therein are controverted as a matter of law.

3. By way of further reply, each and every allegation contained in paragraphs one to ten, inclusive, and in paragraphs seventeen to twenty-three, inclusive, of the "Reply of State of New Jersey to 'Supplemental and Amended Ob-

jections and Defenses of Debtor's Trustees to Claims Filed by the State of New Jersey','' are repeated insofar as they concern statements of fact or law contained in the ''Objections of Institutional Group and the Trustee of the Debtor's General Mortgage to Claim No. 38 Filed by the State of New Jersey'' similar or identical to those contained in ''Supplemental and Amended Objections and Defenses of Debtor's Trustees to Claims Filed by the State of New [fol. 148] Jersey'', to which said paragraphs in the said reply of the State of New Jersey are directed.

Respectfully, Walter D. Van Riper, Attorney-General of the State of New Jersey, Attorney for the State of New Jersey.

Dated: December 28, 1944.

On Order No. 250 re-referring to Special Master the disputed tax claims of the State of New Jersey, all existing or additional objections thereto and the State's reply to said objections and also referring the State's motion to dismiss the Trustees' petition, dated August 12, 1944, for an adjudication of said claims.

IN UNITED STATES DISTRICT COURT

INTERIM REPORT OF SPECIAL MASTER

To the Honorable the Judges of the District Court of the United States for the District of New Jersey:

Augustus C. Studer, Jr., Special Master, hereby reports to this Court as follows:

By order No. 250, heretofore made herein under date of October 16, 1944, all tax claims filed by the State of New Jersey, the Trustees' objections thereto and the State's reply to said objections and, also, the purported special appearance of the State of New Jersey objecting to the jurisdiction of this Court, which special appearance was [fol. 149] filed herein on August 28, 1944, were referred to the undersigned Special Master for hearing and report thereon.

Pursuant to that order, the matter came on to be heard before the Master on Tuesday, December 19, 1944, in the presence of the following:

Shelton Pitney, Esquire and Walter P. Gardner, Esquire, Trustees of the Debtor;

Benjamin C. Van Tine, Esquire, Deputy Attorney General of the State of New Jersey and Milton B. Conford, Esquire, of Counsel;

Willard P. Scott, Esquire and Blair Reiley, Esquire, for Institutional Bondholders;

White and Staples, Esquires and Edwin M. Slote, Esquire, of Counsel, by Robert Carey, Esquire and Edwin M. Slote, Esquire, for the Watters Committee; and

Reynier J. Wortendyke, Jr., Esquire, for the Central Hanover Bank and Trust Company, Trustee of the Debtor's Mortgage.

It was agreed by counsel that the question of the Court's jurisdiction to hear and report on the tax claims of the State of New Jersey would be heard first and an interim report filed by the Master on that question. (See Transcript, p. 68.)

This report deals only with the question of the jurisdiction of this Court to hear and determine, without the consent of the State of New Jersey, the tax claims filed by the State of New Jersey herein.

Considered in this report and submitted with it are:

(1) The petition, dated August 12, 1944, of Shelton Pitney and Walter P. Gardner, Trustees of the properties of the Debtor herein, for adjudication concerning New Jersey State tax claims heretofore filed herein;

[fol. 150] (2) Special appearance filed herein under date of August 28, 1944, of Walter D. Van Riper, Attorney General of the State of New Jersey, for the sole purpose of objecting to the jurisdiction of the Court to entertain petition for adjudication concerning New Jersey State tax claims and for Order No. 250;

(3) Proofs of claims Nos. 34, 35, 36, 37 and 38, filed by the State of New Jersey herein;

(4) Objections to proofs of claims Nos. 34, 35, 36, 37 and 38, filed by the Debtor and its Trustees;

(5) Reply of claimant, State of New Jersey, to Trustees' objections to tax claims;

(6) Supplemental and amended objections and defenses of Debtor's Trustees to the claim filed by the State of New Jersey;

(7) Reply of State of New Jersey to Supplemental and amended objections and defenses of Debtor's Trustees to claims filed by the State of New Jersey;

(8) Objections of Watters Committee, dated December 18, 1944, in support of Trustees' opposition to Claim No. 38 for $19,849,790.21, for alleged taxes and interest, filed on December 10, 1940, by the State of New Jersey in these proceedings:

(9) Reply of State of New Jersey, dated December 29, 1944, to objections of Watters Committee in support of Trustees' opposition to Claim No. 38 for $19,849,790.21, for alleged taxes and interest, filed on December 10, 1940, by the State of New Jersey in these proceedings;

(10) The brief filed herein on behalf of Walter D. Van Riper, Attorney General of New Jersey, appearing specially;

[fol. 151] (11) Trustees' brief, filed herein in opposition to motion to dismiss the petition of the Trustees;

(12) Memorandum of Institutional Group and the Trustees of the Debtor's general mortgage in opposition to motion of Walter D. Van Riper, Attorney General of the State of New Jersey, to dismiss Trustees' petition for adjudication regarding New Jersey State Tax Claims;

(13) Reply of State of New Jersey, dated December 29, 1944, to objections of Institutional Group and the Trustee of the Debtor's general mortgage to Claim No. 38 filed by the State of New Jersey;

(14) The transcripts of the testimony taken at the hearings before the Master on November 8, 1944 and December 19, 1944;

(15) The exhibits offered at the hearing before the Master on December 19, 1944.

The Trustees of the Debtor filed objections and supplemental and amended objections and defenses to the claims filed by the State of New Jersey herein and also filed their petition for adjudication concerning the New Jersey State tax claims hereinabove referred to, in which, among other things, they prayed (Petition, p. 24) that this Court adjudicate "to what extent, if at all, the proofs

of claim of the State of New Jersey should be allowed." Other prayers are contained in that petition, but the prayer last above quoted is the only one substantially involved in this report, because at the hearing before the Master the question was presented and argued by counsel on that basis.

The State of New Jersey, by its Attorney General, specially appearing, contends that is was not the intention of Congress, by Section 77 of the Bankruptcy Act, to confer upon this Court power "to make an adjudication that [fol. 152] will be binding upon the sovereign State of New Jersey concerning the amount of the tax debt that is due and payable to the State, which is a paramount lien upon the properties of the debtor within its boundaries, or an adjudication in anywise concerning or affecting such liens" (Brief, p. 1); also, that if the act be so construed, it is unconstitutional, as violating the State's sovereign immunity from suit under the Eleventh Amendment to the Constitution (Brief, p. 16); also, that Section 64 (a) of the Bankruptcy Act does not confer such power upon this Court in this proceeding, because the claims of the State herein are secured by liens (Brief, p. 20).

The constitutional immunity of the State of New Jersey from a suit in a federal Court, without its consent, is admitted as a general proposition.

On behalf of the State, both in the brief filed by the Attorney General, and in the argument made at the hearing, it was vigorously contended that the Comptroller of the State of New Jersey, in verifying the proofs of claims in these proceedings, which were filed in the name of the State of New Jersey as claimant, by so doing, did not and could not waive any immunity from suit which the State of New Jersey had.

The Trustees maintain that they are defending the debtor's estate against the State's claims; that the State is the claimant and actor; that there is a fund in Court—an estate in custodia legis—in which the State claims an interest and against which it asserts its claims (Trustees' brief, p. 2). They maintain further that they resist, but seek no recovery from the State and assert no right, title or interest in and to any property of the State; they say their petition herein reveals certain of their defenses to the State's proofs of claim, including defenses which have

arisen since their original objections were filed and that [fol. 153] it supplements the defenses stated in those objections (Trustees' brief, p. 2).

From the testimony taken at the hearing before the Master and the exhibits then marked in evidence, the Master makes the following findings of fact:

(1) The State's proofs of claim in these proceedings, numbered 34, 35, 36, 37 and 38, were filed in the name of the State of New Jersey as Claimant. They were signed and verified by Frank J. Murray, "Comptroller of the Treasury of New Jersey." They designated David T. Wilentz, Attorney General, State House, Trenton, New Jersey, as "Attorney Authorized to Represent Claimant" and on their backs the following appears: "Claim of State of New Jersey, David T. Wilentz, Attorney for Claimant, Address: State House, Trenton, N. J." In the body of each of those claims, Paragraph (4) says:

> "(4) Security or lien, if any, for said claim: Answered in (10) below."

Also, in the body of each of those claims, Paragraph 10 says:

> "(10) Lien, priority or preferential classification, if any, claimed for the claim, or any part thereof, the reasons therefor and full statement of the facts respecting same:
>
> "The statute of New Jersey provides that these taxes shall be a lien paramount to all other liens upon all the lands and tangible property and franchises of the company in this State (Section 9, Chapter 208, P. L. 1888, as amended and supplemented; Section 54:27-4, Revised Statutes). The lien shall take effect on June 1 of the year in which the tax is payable."

[fol. 154] (2) The Trustees filed objections in these proceedings to proofs of claim Nos. 34, 35, 36, 37 and 38.

(3) The State of New Jersey filed in these proceedings Reply of Claimant, State of New Jersey, to Trustees' objections to tax claims (Nos. 34, 35, 36, 37 and 38). That reply was signed "David T. Wilentz, Attorney General, Attorney for Claimant, State of New Jersey, State House, Trenton, New Jersey;"

(4) A petition was filed by the State of New Jersey in the Erie Railroad reorganization proceedings then pending in the District Court of the United States for the Northern District of Ohio, Eastern Division, for leave to file its claim against the Trustees for the unpaid balance of taxes and assessments for the years 1939 and 1940, inclusive. That petition was signed "David T. Wilentz, Attorney General, State House, Trenton, New Jersey. Spieth, Taggert, Spring & Annat, By Paul H. Keough, of Counsel, 1568 Union Commerce Building, Cleveland, Ohio. Attorneys for Claimant, State of New Jersey" (Exhibit T-8, December 19, 1944);

(5) Order No. 404, filed February 28, 1942, was made by R. N. Wilkin, District Judge, in the said reorganization proceedings of the Erie Railroad authorizing the State of New Jersey to file its claim for 1939 and 1940 taxes (Exhibit T-9, December 19, 1944);

(6) In the said reorganization proceedings of the Erie Railroad Company a proof of claim was filed in which the State of New Jersey was the claimant. That claim was signed and verified by Frank J. Murray, "Comptroller of the Treasury" and it designated David T. Wilentz, Attorney General, State House, Trenton, New Jersey. as "Attorney Authorized to Represent Claimant." In the body of the claim, Paragraph (4) says:

> [fol. 155] "(4) Security of lien, if any, for said claim: Statutory paramount lien on property for 1933 to 1937, inclusive, taxes; such lien on 1938 taxes attaches on November 1, 1938."

Also, in the body of the claim, Paragraph (10) says:

> "(10) Priority or preferential classification, if any, claimed for the claim, or any part thereof, the reasons therefor and full statement of the facts respecting same: Established by statute as a lien paramount to all other liens upon the lands, tangible property and franchises of Debtor from and after November 1, of the year for which the taxes for each year are assessed, respectively."

(Exhibit T-10, December 19, 1944);

(7) An answer to proof of claim No. D-17 of the State of New Jersey was filed by the Trustees of the property of Erie Railroad Company in the said reorganization proceedings of that company (Exhibit T-11, December 19, 1944);

(8) A reply was filed in the said Erie reorganization proceedings to the answer and objections of the Trustees to the proof of claim filed therein by the State of New Jersey for unpaid taxes levied by the State of New Jersey upon the property and franchise of Erie Railroad Company, Debtor. That reply was signed "David T. Wilentz, Attorney General, Attorney for Claimant, State of New Jersey, State House, Trenton, New Jersey" (Exhibit T-12, December 19, 1944);

(9) A supplemental answer to proof of claim No. D-17 of State of New Jersey was filed by the Trustees of the property of the Erie Railroad Company in the said Erie [fol. 156] reorganization proceedings (Exhibit T-13, December 19, 1944);

(10) A reply to the supplemental answer filed by the Trustees in the said Erie reorganization proceedings to proof of claim No. D-17 of the State of New Jersey, and theretofore filed therein, was also filed in the said Erie reorganization proceedings. That reply was signed "David T. Wilentz, Attorney General of the State of New Jersey and Spieth, Taggert, Spring & Annat, by Paul H. Keough, of Counsel, 1568 Union Commerce Building, Cleveland, Ohio. Attorneys for Claimant, State of New Jersey" (Exhibit T-14, December 19, 1944);

(11) A proof of claim for taxes for the years 1939 and 1940 against Erie Railroad Company, Debtor, was filed in the said reorganization proce-dings of that company. That claim was signed:

> "State of New Jersey Name of Claimant by Homer C. Zink, Comptroller of the Treasury."

It was verified by Homer C. Zink, who swore that he was "the Comptroller of the Treasury of claimant herein." In the body of the claim Paragraph (4) says:

> "(4) Security or lien, if any, for said claim: The State of New Jersey has a statutory paramount lien

on the property of this debtor as to the 1939 tax. This lien took effect June 1, 1939, and as to the 1940 tax, this lien took effect on June 1, 1940."

Also, in the body of the claim Paragraph (8) says:

"(8) Priority or preferential classification, if any, claimed for the claim, or any part thereof, the reasons [fol. 157] therefor and full statement of the facts respecting same: Claim for these taxes is by statute a lien paramount to all other liens upon the lands, tangible property and franchises of debtor, from and after June 1 of the years 1939 and 1940, respectively."

(Exhibit T-15, December 19, 1944);

(12) Answers to proof of claim supplemental D-17 of State of New Jersey were filed in the said Erie reorganization proceedings by H. A. Taylor, Vice-President and General Counsel and Robert E. Woodruff and John A. Haddon, Trustees of the Property of Erie Railroad Company, by H. A. Taylor, Counsel for Trustees, respectively (Exhibits T-16 and T-17, December 19, 1944);

(13) A reply was filed by the State of New Jersey as claimant in the said Erie reorganization proceedings to the answer of Erie Railroad Company to proof of claim supplemental to No. D-17. This reply was signed "David T. Wilentz, Attorney General of the State of New Jersey and Spieth, Taggert, Spring & Annat, by Paul H. Keough, Attorneys for Claimant, State of New Jersey (Exhibit T-18, December 19, 1944);

(14) A further reply to the answer of the Trustees to proof of claim supplemental No. D-17 was filed in the said Erie reorganization proceedings by the State of New Jersey. It was signed "David T. Wilentz, Attorney General of the State of New Jersey and Spieth, Taggert, Spring & Annat, by Paul H. Keough, Attorneys for Claimant, State of New Jersey" (Exhibit T-19, December 19, 1944);

(15) A second supplemental answer to proof of claim No. D-17 of State of New Jersey was filed by the Trustees in the said Erie reorganization proceedings (Exhibit T-20, December 19, 1944);

[fol. 158] (16) A reply was filed by the State of New Jersey in the said Erie reorganization proceedings to the

second supplemental answer filed herein by the Trustees and signed "David T. Wilentz, Attorney General of the State of New Jersey and Spieth, Taggert, Spring & Annat, by Paul H. Keough, Attorneys for Claimant, State of New Jersey" (Exhibit T-21, December 19, 1944);

(17) An amendment was filed by the State of New Jersey as claimant in the said Erie reorganization proceedings to the reply theretofore filed therein to the Trustees' answer. This amended reply was signed "David T. Wilentz, Attorney General, Attorney for Claimant, State of New Jersey, State House, Trenton, New Jersey" (Exhibit T-22, December 19, 1944);

(18) In the reorganization proceedings in this Court of Northern Railroad Company of New Jersey, Debtor, which were also brought under Section 77, David T. Wilentz, as Attorney General of New Jersey, gave notice under date of October 18, 1939, to Northern Railroad Company of New Jersey and its Trustees that on November 2, 1939, he would apply to Thomas W. Trenchard, one of the Justices of the Supreme Court of the State of New Jersey, for an order that the unpaid part of the tax levied by the State Tax Commissioner against the Northern Railroad Company of New Jersey for the year 1933, pursuant to statutes referred to in that notice, be made a matter of record of that Court and judgment entered thereon. That notice is attached to and made a part of Exhibit W-2, December 19, 1944;

(19) Based upon the petition of the Trustees of Northern Railroad Company of New Jersey (Exhibit W-2, December 19, 1944) this Court made an order dated November 1, 1939, enjoining David T. Wilentz, Attorney General of the State of New Jersey, from taking any proceedings [fol. 159] under or pursuant to the notice (last above referred to) theretofore served upon those Trustees by the said David T. Wilentz, Attorney General (Exhibit W-3, December 19, 1944);

(20) In the same proceedings the Attorney General of the State of New Jersey advised the Trustees of the Northern Railroad Company of New Jersey that he had no objection to the allowance of the injunction prayed for by them (Exhibit W-6, December 19, 1944) and the restraint against him was continued (Exhibit W-7, December 19, 1944);

(21) In the reorganization proceedings in this Court of the Susquehanna Railroad Company, a proof of claim was filed against the railroad for taxes due the State of New Jersey. In filing that proof of claim in those proceedings, the same course was pursued which was pursued in filing the claims in these proceedings and the claims there filed were in the same form and tenor as the proofs of claims filed in these proceedings. (See stipulation between counsel, Testimony, pp. 63 to 64.)

With reference to the general duties of the State Comptroller, *N. J. R. S. 54:19-10,* provides:

"The state comptroller shall:

"a. Superintend the collection of the revenue;

"b. Take general charge and supervision of all rights, interest and property of the state;

"c. Institute and direct prosecution against delinquent officers of the revenue, and for just claims and debts due to the state;"

With reference to the general duties of the Attorney General of the State of New Jersey, *N. J. R. S. 52:17-2,* provides:

[fol. 160] "The attorney general shall, when not incompatible with his other public duties:

* * * * * * *

"g. Attend generally to all matters in which the state is a party or in which its rights and interests are involved;"

Based upon the course of conduct of the Comptroller and of the Attorney General in the other reorganization proceedings above mentioned, namely, the Erie Railroad Company, the Susquehanna Railroad Company and the Northern Railroad Company of New Jersey, and considering the statutes last above quoted with reference to the duties of those officers, it is the opinion of the Master that in connection with the filing of the claims of the State of New Jersey in these proceedings the Comptroller and the Attorney General acted in pursuance of their statutory duties and that the proofs of claims of the State of New Jersey filed in these proceedings were properly filed.

Section 77 of the Bankruptcy Act (c) provides:

"(7) The Judge shall promptly determine and fix a reasonable time within which the claims of creditors may be filed or evidenced and after which no claim not so filed or evidenced may participate except on order for cause shown, the manner in which such claims may be filed or evidenced and allowed, and for the purposes of the plan, and its acceptance, after notice and hearing the division of creditors and stockholders into classes according to the nature of their respective claims and interests," etc.

Sub-section (c) of the same Act also provides:

"(13) The judge may on his own motion • • • refer any matters for consideration and report, either [fol. 161] generally or upon specified issues, to one of several special masters who shall have been previously designated to act as special masters in any proceedings under this section by order of any circuit court of appeals," etc.

The same Act, in discussing a plan of reorganization in sub-section (b), provides, among other things, for "the sale of all or any part of the property of the debtor either subject to or free from any lien at not less than a fair upset price, the distribution of all or any assets, or the proceeds derived from the sale thereof, among those having an interest therein, the satisfaction or modification of any liens," etc.

Sub-section (b), Paragraph (5) of the same Act provides:

"The term 'creditors' shall include, for all purposes of this section all holders of claims of whatever character against the debtor or its property," etc.

The same sub-section (b), Paragraph (5), also provides:

"The term 'claims' includes debts, whether liquidated or unliquidated, securities (other than stock and option warrants to subscribe to stock), liens, or other interests of whatever character."

Sub-section (a) of the same Act provides that the Court "shall, during the pendency of the proceedings under this

section and for the purposes thereof, have exclusive jurisdiction of the debtor and its property wherever located, and shall have and may exercise in addition to the powers conferred by this section all the powers, not inconsistent with this section, which a Federal court would have had if it had appointed a receiver in equity of the property of the debtor for any purpose."

[fol. 162] Sub-section (1) of the same Act provides:

> "(1) In proceedings under this section and consistent with the provisions thereof, the jurisdiction and powers of the court, the duties of the debtor and the rights and liabilities of creditors, and of all persons with respect to the debtor and its property, shall be the same as if a voluntary petition for adjudication had been filed and a decree of adjudication had been entered on the day when the debtor's petition was filed."

In the opinion of the Master, the foregoing provisions confer upon this Court jurisdiction over the kinds of claims asserted by the State in this proceeding and such construction of the Act is not unconstitutional as against the State, but is within the power conferred upon the Congress by the Federal Constitution to *etsa*blish uniform laws on the subject of bankruptcies. *Van Huffel* v. *Harkelrode*, 284 U. S., p. 225; *New York* v. *Irving Trust Company, Trustee in Bankruptcy*, 288 U. S., p. 329.

The fact is, and the Attorney General of the State of New Jersey so asserts, that the State of New Jersey has claims for taxes against the Debtor, regardless of the effect of the filing of the formal proofs of claims in these proceedings because of the powers or lack of powers of any officer of the State in connection with the filing of those formal proofs of claims. These claims, he asserts, are secured by liens upon the Debtor's property. In the opinion of the Master, that property is in the custody of the Court by its Trustees, who have been duly appointed pursuant to Section 77 in these proceedings. That being so, by filing their petition, the Trustees are seeking an opportunity in this Court to defend the property of the Debtor, now in the custody of this Court, against alleged improper claims to that property. In the opinion of the Master, by so doing, the Trustees are not [fol. 163] violating the sovereign immunity of the State of New Jersey from suit.

Section 64 (a) of the Bankruptcy Act, dealing with the priority of debts and the order of payment, provides:

> "(a) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be * * * (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof; Provided, That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court, and Provided Further, That in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court."

Doubt has been cast upon the applicability of the above section to proceedings under Section 77 by the case of *Arkansas Corporation Commission* v. *Thompson*, 313 U. S., p. 132, but subsequent decisions of District Courts and Circuit Courts of Appeals have construed that case as denying jurisdiction to re-determine the amount of tax claims in limited situations, for example, where the valuation of property has been previously determined by a quasi-judicial taxing body. *Lyford* v. *State of New York*, 140 F. (2d) p. 840, 2d Cir.; *in re Monongahela Rye Liquors*, 141 F. (2d) p. 864, 3d Circ.

Both in his brief and on the oral argument, the Attorney General conceded that the Bankruptcy Court has the power as against the State to determine the validity of tax claims of the State, where such claims are unsecured. (Brief, p. 20, citing *New Jersey* v. *Anderson*, 203 U. S., p. 483.) The Attorney General makes a distinction between the effect of [fol. 164] the State's assertion of unsecured claims and the effect of the State's assertion of secured claims. He argues that when asserting an unsecured claim, the State is applying to be paid out of assets *in custodia legis*, but when the claims of the State are secured by liens, the lien interests of the State are not *in custodia legis* and so any proceedings in this Court affecting those liens, such as the Trustees' petition, is a suit against which the State has sovereign immunity.

In the opinion of the Master, the entire property of the railroad is *in custodia legis*, subject, however, to such rights

as are given by law to lienholders. The cases cited by the Attorney General do not hold otherwise. Having custody of the property, the Bankruptcy Court, subject to the limitation expressed in the case of *Arkansas Corporation Commission* v. *Thompson*, 313 U. S., p. 132, *supra*, which limitation is not now involved, is the proper Court to determine the validity and amount of the tax claims of the State of New Jersey and the incidental liens alleged to affect the property in the custody of the Court. *Isaacs* v. *Hobbs Tie & T. Co.*, 282 U. S., p. 734, at p. 738.

It is the opinion of the Master that the claim of the State to sovereign immunity should be denied and that the petition of the Trustees should not be dismissed.

Respectfully submitted, Augustus C. Studer, Jr., Special Master.

Dated: January 17th, 1945.

[fol. 165] IN UNITED STATES DISTRICT COURT

OBJECTIONS OF STATE OF NEW JERSEY TO INTERIM REPORT OF SPECIAL MASTER

To the Honorable the Judges of the District Court of the United States for the District of New Jersey:

Walter D. Van Riper, as Attorney-General of the State of New Jersey, does herewith, pursuant to the notice of William H. Tallyn, Clerk of the Court, dated January 19, 1945, make the following objections to the Interim Report of Augustus C. Studer, Jr., Special Master, dated January 17, 1945, and filed on said date.

1. The Special Master erred in recommending that the petition of the Trustees of August 12, 1944, should not be dismissed.

2. The Special Master erred in failing to recommend that the motion of Walter D. Van Riper, Attorney-General of the State of New Jersey, appearing specially, to dismiss the said petition for the reasons stated in said motion and special appearance and on the argument, be granted.

3. The Special Master erred in concluding "that the claim of the State to sovereign immunity should be denied."

4. The statement in the said report on page 2, thereof, as follows,

> "It was agreed by counsel that the question of the Court's jurisdiction to hear and report on the tax claims of the State of New Jersey would be heard first . . .",

is erroneous in fact in that the question of jurisdiction raised by the Attorney-General concerned the jurisdiction of the Court to hear any part of the petition of the Trustees [fol. 166] dated August 12, 1944, or to adjudicate with respect to any of the prayers contained therein as against the State of New Jersey, without the consent of the State.

5. The Special Master erred in limiting his report, as he states he has done on page 2 thereof, to "the question of the jurisdiction of this Court to hear and determine, without the consent of the State of New Jersey, the tax claims filed by the State of New Jersey herein," since the objection and motion of the Attorney-General was to the jurisdiction of the Court to hear any part of the petition of the Trustees, dated August 12, 1944, or to adjudicate with respect to any of the prayers therein contained as against the State of New Jersey, without the consent of the State.

6. The statement in said report on page 4 thereof, as follows,

> "The Trustees of the Debtor filed objections and supplemental and amended objections and defenses to the claims filed by the State of New Jersey herein and also filed their petition for adjudication concerning the New Jersey State tax claims hereinabove referred to, in which, among other things, they prayed (Petition, p. 24) that this Court adjudicate 'to what extent, if at all, the proofs of claim of the State of New Jersey should be allowed.' Other prayers are contained in that petition, but the prayer last above quoted is the only one substantially involved in this report, because at the hearing before the Master the question was presented and argued by counsel on that basis,"

is erroneous in that the question presented at the hearing before the Master was not limited to the jurisdiction of the [fol. 167] Court to adjudicate "to what extent, if at all, the

proofs of claim of the State of New Jersey should be allowed," but extended to the jurisdiction of the Court to adjudicate any of the matters raised in any of the prayers of the petition of the Trustees of August 12, 1944.

The said statement is further erroneous in that there is no prayer in said petition as described in said quoted excerpt from the report of the Special Master. The prayer referred to by the Special Master is actually one for a determination as to whether, if any contract made by the petitioners with State of New Jersey is "not binding on the parties thereto including petitioners, to what extent, if at all, the proofs of claim of the State of New Jersey should be allowed."

7. The statement beginning in the last paragraph on page 4 of said report as to the contention of the State of New Jersey with respect to Section 77 of the Bankruptcy Act, quoting the brief of the Attorney-General, at page 1 thereof, in asserted substantiation of the restatement of said contention, is erroneous. There is no reference at page 1 of said brief to Section 77 of the Bankruptcy Act, as represented in the said report of the Special Master, and the position of the State with respect to jurisdiction, as is specifically stated in the second sentence on page 1 of said brief of the Attorney-General, is that there is no jurisdiction in this Court to entertain the said Trustees' petition "against the State of New Jersey, without its consent." The Attorney-General did not and does not take any position that jurisdiction in this Court is lacking, under Section 77 of the Bankruptcy Act, in any case where the State does consent to be made a party and thereby submits to the exercise of jurisdiction over it.

8. The reference in said report to the position of the Attorney-General with respect to the Eleventh Amend-
[fol. 168] ment to the Constitution, at page 5 of said report, referring to the said brief at page 16 of said brief, is erroneous in that there is no specific reference at page 16 of the brief to the Eleventh Amendment and further in that the position of the Attorney-General with respect to immunity under the Eleventh Amendment is based upon the premise that the State shall not have consented to the exercise of such jurisdiction.

9. The statement at page 5 of said report, referring to the brief of the Attorney-General at page 20 of said brief,

and purportedly representing the Attorney-General's position with respect to Section 64a of the Bankruptcy Act, is erroneous in that the position of the Attorney-General is not only that Section 64a of the Bankruptcy Act does not confer jurisdiction upon this Court over the claims of the State because they are secured by liens, but also that said Section cannot constitutionally grant any jurisdiction to this Court "to render an adjudication binding against a State, without its consent, of the taxes due and owing to it" (page 18 of said brief).

10. The Special Master erroneously admitted in evidence, over objection by the Attorney-General, the documents listed as items (3), (4), (5), (6), (7), (8), (9), (10), (11), (12), (13), (14), (15), (16), (17), (18), (19), (20), and (21), set forth at pages 6, 7, 8, 9, 10, 11 and 12 of his said report, for the reason that none of said documents are material relevant or competent upon the issue of jurisdiction in this case.

11. The Special Master erred in relying upon the evidence referred to in the paragraph next hereinabove, for his conclusions stated in the first paragraph on page 13 of said report, because of the incompetence of said evidence. [fol. 169] 12. At page 13 of his said report, the Special Master states the following:

> "Based upon the course of conduct of the Comptroller and of the Attorney-General in the other reorganization proceedings above mentioned, namely, the Erie Railroad Company, the Susquehanna Railroad Company and the Northern Railroad Company of New Jersey, and considering the statutes last above quoted with reference to the duties of those officers, it is the opinion of the Master that in connection with the filing of the claims of the State of New Jersey in these proceedings the Comptroller and the Attorney-General acted in pursuance of their statutory duties and that the proofs of claims of the State of New Jersey filed in these proceedings were properly filed."

If, as appears from the context of the said report as a whole, the Special Master was intending by the foregoing language to make a finding that in filing the proofs

of claim the Comptroller or the Attorney-General were intending to submit the tax debt liens of the State of New Jersey for enforcement or adjudication to the Bankruptcy Court or that the statutes of New Jersey authorize such action by said officers, the same is erroneous in fact and in law and is not supported either by the evidence referred to in paragraph 10 hereinabove as having been erroneously admitted in evidence, or by the statutes of the State of New Jersey.

The several items of evidence referred to in paragraph 10 hereinabove, and which the Special Master refers to as the "course of conduct of the Comptroller and of the Attorney-General," were offered in evidence by the Trustees and Intervenors as purportedly establishing a practical contemporaneous construction of the said statutes contrary to the position taken by the Attorney-General here with [fol. 170] respect to the significance and effect of the filing of the proofs of claim in the present reorganization proceedings. Said evidence was incompetent for said purpose because (1) there is no ambiguity in said statutes which is properly susceptible of resolution by any showing of practical contemporaneous construction, and (2) said former actions of the Attorney-General and the Comptroller do not represent the taking of any position by the State of New Jersey inconsistent with the position which the State now takes with respect to the significance of the filing by the Comptroller of the proofs of claim in the present reorganization proceedings and (3) there is no showing of a course of practical construction sufficiently uniform and long continued to satisfy the rule with respect to contemporaneous practical construction of statutes.

13. The conclusion of law made by the Special Master in his said report at page 15 thereof, as follows,

> "In the opinion of the Master, the foregoing provisions confer upon this Court jurisdiction over the kinds of claims asserted by the State in this proceeding and such construction of the Act is not unconstitutional as against the State, but is within the power confered upon the Congress by the Federal Constitution to establish uniform laws on the subject of bankruptcies"

is improper for the following reasons:

(a) It is not responsive to the position taken by the Attorney-General in moving to dismiss the petition of the Trustees.

(b) The State does not "assert" any claims "in this proceeding" in the sense of submitting its tax debt liens for enforcement or adjudication, or to any judicial action [fol. 171] under the supposed authority of the Bankruptcy Act. The filing of the proofs of claim was a mere notification to the Trustees, the Debtor and to the Court of the existence and amount of such liens.

(c) The statement in the said conclusion of law of the Special Master that the said provisions of the Bankruptcy Act grant this Court jurisdiction to adjudicate concerning tax liens of the State of New Jersey and that said act is not unconstitutional in said respect, "but is within the power conferred upon the Congress by the Federal Constitution to establish uniform laws on the subject of bankruptcies," is not responsive to the position and contention of the Attorney-General that, assuming the existence of general statutory jurisdiction over the subject matter of liens upon property of the Debtor, it is necessary for the Bankruptcy Court also to secure jurisdiction over the person of the lienor in order to make adjudications concerning liens, and that such jurisdiction cannot be obtained over the person of a sovereign State without its consent because that would be tantamount to a suit against such State without its consent.

14. The conclusions of law of the Special Master in his said report at page 15, as follows,

> "The fact is, and the Attorney-General of the State of New Jersey so asserts, that the State of New Jersey has claims for taxes against the Debtor, regardless of the effect of the filing of the formal proofs of claims in these proceedings because of the powers or lack of powers of any officer of the State in connection with the filing of those formal proofs of claims. These claims, he asserts, are secured by liens upon the Debtor's property. In the opinion of the Master, that property is in the custody of the Court, by its [fol. 172] Trustees, who have been duly appointed

pursuant to Section 77 in these proceedings. That being so, by filing their petition, the Trustees are seeking an opportunity in this Court to defend the property of the Debtor, now in the custody of this Court, against alleged improper claims to that property. In the opinion of the Master, by so doing, the Trustees are not violating the sovereign immunity of the State of New Jersey from suit"

are erroneous in that:

(a) The specific conclusion that "the Debtor's property" "is in the custody of the Court" is erroneous if it is intended thereby to imply that all property rights in and to said property, including the interest represented by the lien of the State of New Jersey for tax debts owing to it, are in the custody of the Court. Such interest of the State of New Jersey was a perfected lien at the institution of the reorganization proceedings and did not come within the custody or jurisdiction of the Court upon the institution of such proceedings and could not thereafter come within such custody or jurisdiction unless the State was made a party to said proceedings. The State was never made a party and cannot be made a party without its consent.

(b) The specific conclusion of the Special Master that the Trustees, "by filing their petition," are defending the property of the Debtor against alleged improper claims to that property, is erroneous in that the State has not yet and is not now asserting its said liens for enforcement in these proceedings.

(c) The Master erred in determining in the foregoing excerpt of his report that the Trustees in so doing "are not violating the sovereign immunity of the State of New Jersey from suit."

[fol. 173] 15. The Special Master erred in his said report, at page 16 thereof, in finding that,

"Both in his brief and on the oral argument, the Attorney-General conceded that the Bankruptcy Court has the power as against the State to determine the validity of tax claims of the State, where such claims are unsecured. (Brief, p. 20, citing *New*

Jersey vs. *Anderson*, 203 U. S., p. 483.) The Attorney-General makes a distinction between the effect of the State's assertion of unsecured claims and the effect of the State's assertion of secured claims. He argues that when asserting an unsecured claim, the State is applying to be paid out of assets in custodia legis, but when the claims of the State are secured by liens, the lien interests of the State are not in custodia legis and so any proceedings in this Court affecting those liens, such as the Trustees' petition, is a suit against which the State has sovereign immunity,"

for the following reasons:

(a) The Attorney-General did not and does not concede that the Bankruptcy Court has the power to determine the validity or tax claims of a state, without its consent, where such claims are unsecured. The distinction which the Attorney-General made between secured claims and unsecured claims of a state against a bankrupt is that the assertion by a state of an unsecured claim must be regarded as an affirmative prosecution of its demand in the bankruptcy proceedings, and therefore as a submission to the jurisdiction of the Court as a party claimant, since the State would otherwise be powerless to share in the general assets of the bankrupt. Where the claim of the state is secured, on the other hand, the claimant may be regarded as standing on [fol. 174] its lien, outside the jurisdiction of the Court, unless it is made a party in proceedings to adjudicate or otherwise affect said lien. A sovereign state cannot thus be made a party without its consent.

(b) The Special Master in the foregoing excerpt erroneously states that the Attorney-General makes a distinction "between the effect of the State's assertion of unsecured claims and the effect of the State's assertion of secured claims." The Attorney-General has made no such distinction between the effect of "assertions" in reorganization proceedings, if the word "assertion" is intended to imply a demand to be enforced against the Debtor's estate in such proceedings.

16. The conclusion of law of the Special Master in his said report, at page 16, that the Bankruptcy Court "is the proper court to determine the validity and amount of the

tax claims of the State of New Jersey and the incidental liens alleged to affect the property in the custody of the Court" is erroneous in that the Bankruptcy Court cannot properly make any adjudication concerning the tax claims or liens of the State of New Jersey unless the State voluntarily becomes, or is lawfully made a party to said proceedings. In the present case the State has not voluntarily submitted its lien claims for enforcement or adjudication in the Bankruptcy Court nor has it lawfully been made a party. Nor can it be made a party to said proceedings without its consent with respect to such liens.

Respectfully submitted, Walter D. Van Riper, As Attorney-General of New Jersey.

Dated January 27, 1945.

[fol. 175] IN UNITED STATES DISTRICT COURT, DISTRICT OF NEW JERSEY

OPINION

Confirming Special Master's Report

APPEARANCES:

Shelton Pitney, Esq., Walter P. Gardner, Esq., Trustees.
Benjamin C. Van Tine, Esq., for the State of New Jersey.
Edwin M. Slote, Esq., Attorney for Watters Committee.
Blair Reilly, Esq., Attorney for Inst. Group of Bondholders.

FAKE, District Judge:

The issue here arises in a railroad reorganization proceeding under Section 77 of the Bankruptcy Act.

The State of New Jersey through its Comptroller filed certain proofs of claim with the trustees herein for unpaid taxes due the State.

An Order of Reference was made by me directing the Special Master, appointed under Section 77 (c) (13) of the Act, to hear and report on the amount and validity of said tax claims.

The Attorney General of the State contended before the Master, and as well here, that this court is without

jurisdiction to hear and adjudicate the tax claims as in said Order of Reference provided.

The Master has forwarded to this court the record made before him on the subject of jurisdiction, together with the briefs filed before him, and has filed his report thereon holding that this court does have jurisdiction and [fol. 176] that the theory of the sovereign immunity of the State does not apply.

The issue is now before me on motion to adopt and confirm the Master's report.

Upon a consideration of the said Master's report and the record returned therewith, together with the substance of the briefs and oral arguments made before me, I am of the opinion that this court has jurisdiction as asserted and that the Master's report should be adopted and confirmed in all things.

An order will be entered herein overruling the objections and confirming the Master's report.

I will hear counsel on the form of the order.

Filed February 21, 1945.

[fol. 177] In United States District Court

Order No. 271 Overruling Objections of State of New Jersey to Interim Report of Special Master Dated January 17, 1945 and Confirming Said Report

This Court by Order No. 66 in this cause dated October 7, 1940 having required the claims of all creditors "including all claims of whatever character" against the Debtor "or its property" to be filed by December 31, 1940 in the form and manner prescribed by said order, and the State of New Jersey having thereupon, within time and in the form prescribed by said order, filed its proofs of claim (Nos. 34-38) for balances of taxes alleged to be due to it from the Debtor and for interest or interest penalties on said balances at the rate of 1% per month; and the Trustees having on March 3, 1941 filed objections to said claims to which the State of New Jersey on March 26, 1941 filed its "reply of claimant, State of New Jersey, to Trustees' objections to tax claims"; and this Court by Order No. 93 dated April 1, 1941 having referred all disputed claims (in-

cluding the State's claims aforesaid) to the standing Special Master, "together with all objections thereto, for hearing and report thereon"; and the Legislature of the State of New Jersey having thereupon enacted Chapter 290 of the Laws of New Jersey of 1941, effective July 22, 1941, (subsequently amended by Chapter 241 of the Laws of 1942), known as the Railroad Tax Settlement Act, and this Court by Order No. 123 dated August 8, 1941 having authorized and directed the Trustees of the Debtor to comply with said Act and having thereafter by Order No. 135 dated November 24, 1941 adjudged that the Trustees had taken all steps necessary to comply and should continue to comply with said Act and having by Order No. 163 dated June 12, 1942 revoked so much of said Order No. 93 as referred the State's proofs of claim (Nos. 34-38), as aforesaid, to the standing Special Master for hearing and report thereon; and the United States Circuit Court of Appeals for the [fol. 178] Third Circuit having reversed said Order No. 163 in certain other respects, on the appeal of the State of New Jersey, and having remanded the record on said appeal to this Court to await the determination by the Court of Chancery of New Jersey of the constitutionality of said Railroad Tax Settlement Act unless this Court should find that delay which might be harmful to the Debtor and its creditors might result, in which event this Court might proceed itself to hear and decide the constitutional issue; and, following the decisions of the courts of the State of New Jersey in the suit so referred to by the United States Circuit Court of Appeals, this Court having by Order No. 250 dated October 16, 1944 referred and re-referred to the standing Special Master for hearing and report thereon said tax claims filed by the State of New Jersey, all objections thereto and the State's reply to said objections, and also the State's plea of sovereign immunity from suit filed herein on August 28, 1944, in the form of a special appearance; and supplemental, amended and additional objections and defenses to the State's proofs of claim having thereupon been filed by the Trustees, by the Institutional Group of Bondholders and the Trustee of the Debtor's General Mortgage, and by the Bondholders' Committee known as the Watters Committee, and the State of New Jersey having thereupon filed its further replies to such supplemental, amended and additional objections and defenses; and the Master on December 19, 1944 having taken testimony

and heard argument under said Order No. 250 touching the State's plea of sovereign immunity aforesaid and having on January 17, 1945 filed an interim report wherein he concluded, among other things, that the Court has jurisdiction in the premises and that the plea of sovereign immunity should be denied; and the State of New Jersey having thereupon filed objections to said interim report, and said interim report and the State's objections having [fol. 179] thereupon been duly brought on for hearing and argument before this Court on February 7, 1945, on notice to all interested parties; and the Court having heard the arguments of Benjamin C. Van Tine, Esq., Deputy Attorney General, on behalf of the State of New Jersey, in opposition to confirmation of said interim report and in support of the State's said objections thereto, and of Shelton Pitney, Esq., one of the Trustees of the Debtor, Blair Reiley, Esq. and Willard P. Scott, Esq., of counsel with the Institutional Bondholders' Group, and Edwin M. Slote, Esq., of counsel with the Watters Committee, in support of said interim report, and having considered the record herein; and the Court being of opinion that it has jurisdiction to consider and pass upon the proofs of claim filed by the State, all objections thereto filed with the Special Master and the State's replies to said objections; and that the State's plea of sovereign immunity is inapplicable and therefore without merit:

It is, on this 5 day of March, 1945, Ordered that the objections filed by the State of New Jersey to the interim report of the Special Master dated January 17, 1945 be and the same are hereby overruled, that the Special Master's findings and conclusions as set forth in said report be and they are hereby adopted by this Court and that said report be and the same is hereby confirmed.

Guy L. Fake, United States District Judge.

Filed: March 5, 1945.

[fol. 180] IN UNITED STATES DISTRICT COURT

NOTICE OF APPEAL

To The Central Railroad Company of New Jersey, Debtor, and Shelton Pitney and Walter P. Gardner, Trustees of The Central Railroad Company of New Jersey, Debtor, Central Hanover Bank and Trust Company, Trustee of the Debtor's General Mortgage, Institutional Group of Lienors, Brooks Committee of Bondholders, Watters Committee of Bondholders, and to Whom It May Concern:

SIRS:

Notice is hereby given that the State of New Jersey, by Walter D. Van Riper, Attorney General of New Jersey, hereby Appeals to the United States Circuit Court of Appeals for the Third Circuit from the whole of the Order of the Court No. 271, entered in these proceedings on March 5, 1945, which order is entitled "Order No. 271 Overruling Objections of State of New Jersey to Interim Report of Special Master Dated January 17, 1945 and Confirming Said Report".

State of New Jersey, Appellant, By (S.) Walter D. Van Riper, Attorney-General of New Jersey, Attorney for Appellant.

Dated: April 2, 1945.

[fol. 181] STATEMENT OF POINTS

State of New Jersey, Appellant, by Walter D. Van Riper, Attorney General, herewith states the points on which the Appellant intends to rely on the appeal from Order No. 271, entered March 5, 1945, notice of which was filed April 2, 1945, as follows:

1. The Court erred in determining that the bankruptcy court had the power to make adjudications, binding upon the State of New Jersey, concerning statutory liens that were affixed in and to the property of the debtor as of the date of the filing of the petition in bankruptcy without the consent of the said State of New Jersey.

2. The Court erred in holding that the State of New Jersey had consented thereto.

3. The Court erred in failing to hold that the bankruptcy court was without jurisdiction to make adjudications, binding upon the State of New Jersey, concerning the statutory liens of the said State that were affixed at the time of the institution of the bankruptcy proceedings for the reason that no such adjudication may be made without the consent of the State and the State had not consented thereto.

Respectfully, Walter D. Van Riper, Attorney General of the State of New Jersey, Attorney for Appellant.

Dated: April 6, 1945.

[fol. 182] IN UNITED STATES CIRCUIT COURT OF APPEALS

STIPULATION CONCERNING PORTIONS OF RECORD IN THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF NEW JERSEY IN THE PROCEEDINGS FOR THE REORGANIZATION OF THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, NO. 29,778, FOR USE ON HEARING OF NO. 8861 AND NO. 8889

It is hereby stipulated by and between counsel for the parties to the above entitled proceedings that the following statement correctly recites those portions of the record below which are referred to herein and that this stipulation may be used for all purposes before the United States Circuit Court of Appeals for the Third Circuit on the hearing of its No. 8861 and No. 8889.

1. On October 30, 1939 The Central Railroad Company of New Jersey (hereinafter referred to as the "Debtor") filed in the District Court of the United States for the District of New Jersey a petition for reorganization under and by virtue of Section 77 of the Bankruptcy Act (11 U. S. C. A. 205). On the same day said court approved said petition.

2. By Order No. 66, dated October 7, 1940, said District Court (hereinafter referred to as the "bankruptcy court") required the claims of all creditors, "including all claims of whatever character" against the debtor "or its property" to be filed by December 31, 1940 in the form and manner prescribed by said order.

3. On December 11, 1940 there was filed, in the form prescribed by said Order No. 66, a proof of claim for 1932-39

tax balances allegedly owed by the Debtor to the State of New Jersey. Said proof of claim (since known as "Claim No. 38") was signed and verified by the Comptroller of the State of New Jersey and named the Attorney General of [fol. 183] the State of New Jersey as counsel for the claimant.

4. At the same time there were filed proofs of claim for tax balances allegedly due to the State of New Jersey for said years by subsidiaries of or railroads affiliated with the Debtor. Said proofs of claim (since known as Claims Nos. 34, 35, 36 and 37) were also signed and verified by the Comptroller of the State of New Jeresy and named the Attorney General of the State as counsel for the claimant.

5. In said proofs of claim (Nos. 34-38) a statutory lien for the taxes claimed was asserted and the proofs of claim cited R. S. 54:27-4.

6. On March 3, 1941 the Trustees of the Debtor filed objections to said proofs of claim.

7. On March 26, 1941 there was filed the "Reply of Claimant, State of New Jersey, to Trustees' Objections to Tax Claims." This was signed by the Attorney General of the State of New Jersey as "Attorney for Claimant." Said reply prayed:

> "for the dismissal of said objections, and each of them, and for allowance of the full amount of each of said claims and interest as set forth in Schedule 'A' attached thereto, respectively, together with interest on said taxes, respectively, at the rate of 1% per month and after December 1st, 1940."

8. By Order No. 93 dated April 1, 1941 the bankruptcy court referred all disputed claims to the standing Special Master "together with all objections thereto, for hearing and report thereon." The Special Master was therein [fol. 184] directed to "hear, determine and report upon the order and priority of all claims" and "upon all contested matters to take the testimony and hear argument, make findings of fact, adopt conclusions of law and submit the same to the Court as his report, either with or without opinion."

9. Hearings before the Special Master concerning the State's claims (Nos. 34-38) had not commenced when the

Legislature of New Jersey on July 22, 1941 enacted Chapter 290 of the Laws of 1941, subsequently amended by Chapter 241 of the Laws of 1942 (L. 1941, p. 769; L. 1942, p. 652; 58 N. J. S. A. Cum. Pocket Sup. App. 4-7.1 et seq.).

10. By Orders Nos. 123, 135 and 163 the Trustees of the Debtor were directed by the bankruptcy court to accept and comply with said legislation and the above-mentioned order of reference (Order No. 93) was revoked insofar as the State's claims were concerned.

11. Said legislation led to litigation in state courts which continued for approximately three years. *Wilentz* v. *Hendrickson* 133 N. J. Eq. 447, 33 A. (2d) 336, affirmed 135 N. J. Eq. 244, 38 A. (2d) 199. See also *In re Central Railroad Company of New Jersey* 136 F. (2d) 633, 640 (C. C. A. 3rd).

12. Following the conclusion of the litigation in *Wilentz* v. *Hendrickson supra* the bankruptcy court, on petition of the Trustees dated August 12, 1944, made and entered its Order No. 250, dated October 16, 1944, re-referring the State's claims and all objections thereto to the Special Master for hearing and report thereon. Prior to the entry of Order No. 250, at the hearings held on August 28, September 18 and October 16, 1944 upon the petition of the Trustees for the entry of said order the State of New Jer- [fol. 185] sey, by its Attorney General, appeared specially and challenged the jurisdiction of the bankruptcy court to adjudicate the amount and validity of the State's tax lien claims on the ground that the State had not consented to adjudication of its tax lien claims and that any such adjudication would be made in a suit against the State to which the State had not consented and would violate the State's sovereign immunity.

13. Said plea of sovereign immunity from suit was also referred to the Special Master by said Order No. 250.

14. On January 17, 1945 the Special Master filed an interim report wherein he recommended that the bankruptcy court had jurisdiction to determine the amount and validity of the State's tax lien claims and that the plea of sovereign immunity should be overruled.

15. The State of New Jersey by its Attorney General filed objections to the interim report of the Special Master,

argument whereon was duly heard by the bankruptcy court on February 7, 1945.

16. On February 21, 1945 the bankruptcy court filed a memorandum opinion holding that it had jurisdiction and that the interim report of the Special Master should be confirmed.

17. By Order No. 271 dated March 5, 1945 the bankruptcy court confirmed the interim report of the Special Master and overruled the objections filed by the State of New Jersey.

18. Pursuant to leave granted by the Special Master under the authority conferred upon him by said Order No. [fol. 186] 250 supplemental and amended objections and defenses to the claims of the State of New Jersey were filed by the Trustees of the Debtor and by three intervenors in the reorganization proceedings, being groups of or committees representing holders of the Debtor's bonds. On December 12, 1944 the State of New Jersey filed its "Reply of State of New Jersey to Supplemental and Amended Objections and Defenses of Debtor's Trustees to Claims filed by the State of New Jersey" and shortly thereafter filed replies to the objections of said intervenors.

19. At various times during the progress of said reorganization proceedings the Attorney General of the State of New Jersey has entered his appearance on behalf of the State without denominating such appearances as "special." The Attorney General appeared on November 1, 1939 on the return of an order to show cause why proceedings then pending in the New Jersey Supreme Court for the entry of a judgment against the Debtor for state taxes assessed for the years 1932 and 1933 should not be restrained. He appeared at the hearing on November 27, 1939 touching the selection of trustees of the Debtor and nominated a trustee. He appeared before the Interstate Commerce Commission in Washington, D. C. on December 12, 1939 and objected to the confirmation of one of the Trustees named by the bankruptcy court. He appeared before the bankruptcy court on December 13, 1939 on the application of the Debtor for instructions as to whether it should pay any part of the taxes assessed by the State for the year 1939 and filed an answer praying that the Debtor be directed to

pay 60% of said taxes, or $2,049,553.23; and Order No. 11, so directing, was entered on December 26, 1939. The Trustees duly paid said sum to the Treasurer of the State of New Jersey. He appeared before the bankruptcy court on June 12, 1940 on the Trustees' petition for authority to [fol. 187] pay six monthly installments of $100,000 each on account of the taxes assessed against the Debtor for the tax years 1932 and 1933 and urged that the Trustees be required to pay not less than $200,000 per month, or a total of $1,200,000; and on June 13, 1940 the bankruptcy court entered Order No. 53 directing the Trustees to pay $150,000 per month, or a total of $900,000. The Trustees duly paid said sum in full to the Treasurer of the State of New Jersey. The Attorney General appeared again on December 2 and 16, 1940 concerning payment of the taxes assessed by the State against the Debtor for the year 1940 and filed an answer urging the bankruptcy court to require full payment; and Order No. 72 was entered on December 2, 1940 directing payment of 60% of said taxes. The Trustees duly paid said sum to the Treasurer of the State of New Jersey. He appeared on December 13, 1944 on the hearing of the Trustees' application made pursuant to Section 77 (o), 11 U. S. C. A. 205 (o), to sell at private sale and free from liens certain property of the Debtor known as the Atlantic Highlands Pier, the proceeds to be held subject to liens, and objected to the entry of Order No. 259 dated December 16, 1944 authorizing such lien-free sale. He has appeared in opposition to an application by the Trustees to create a separate operating company for the leased lines of the Debtor situated in Pennsylvania, upon which application no order has yet been made.

20. As stated in the report of the Special Master dated January 17, 1945 and as shown by the exhibits introduced in evidence before the Special Master on December 19, 1944 and by stipulation between the parties at said hearing, the action of the Comptroller of the State of New Jersey in signing and verifying the proofs of claim filed with the Trustees of the Debtor was substantially identical with his action in signing and verifying proofs of claim against each [fol. 188] other railroad under reorganization against which the State has asserted tax lien claims; and in each such other case the Attorney General of the State of New Jersey has been named and has acted as counsel for the State. Said

other proceedings in which said state officers have so acted have been those for the reorganization of the New York, Susquehanna and Western Railroad Company, Erie Railroad Company and Northern Railroad of New Jersey.

It is further stipulated that any party may refer to or quote *in extenso* any of the orders, minutes, exhibits or other portions of the record in the bankruptcy court, in his brief or at the oral argument of No. 8861 and No. 8889, or either of them, or in the course of any review of the judgment or judgments entered therein.

[fol. 189] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, OCTOBER TERM, 1944

No. 8889

In the Matter of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, Debtor; STATE OF NEW JERSEY, Appellant

ORDER ASSIGNING HON. JEROME FRANK FOR ARGUMENT—Filed June 20, 1945

Appeal from the District Court of the United States for the District of New Jersey

And now, to-wit: this 20th day of June A. D. 1945, it is ordered that Hon. Jerome Frank, U. S. Circuit Judge, for the Second Circuit, be, and he is hereby assigned to sit in above case in order to make a full court.

Goodrich, Circuit Judge.

[File endorsement omitted.]

[fol. 189a] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, OCTOBER TERM, 1944

No. 8889

[Title omitted]

MINUTE ENTRY OF HEARING—June 20, 1945

And afterwards, to wit, the 20th day of June, 1945, come the parties aforesaid by their counsel aforesaid, and this case being called for argument sur pleadings and briefs,

before the Honorable Herbert F. Goodrich, Honorable Jerome Frank and Honorable Gerald McLaughlin, Circuit Judges, and the Court not being fully advised in the premises, takes further time for the consideration thereof.

And afterwards, to wit, on the 15th day of November, 1945, come the parties aforesaid by their counsel aforesaid, and the Court, now being fully advised in the premises, renders the following decision:

[fol. 190] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, OCTOBER TERM, 1944

No. 8861

In the Matter of THE APPLICATION OF THE STATE OF NEW JERSEY FOR A WRIT OF PROHIBITION

No. 8889

In the Matter of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, Debtor; STATE OF NEW JERSEY, Appellant

On Appeal from Order No. 271 of the United States District Court for the District of New Jersey

In Proceedings for Reorganization of a Railroad

Before Goodrich, Frank and McLaughlin, Circuit Judges

[fol. 191] OPINION OF THE COURT—Filed November 15, 1945

By McLAUGHLIN, Circuit Judge:

These matters have to do with taxes allegedly due and owing the State of New Jersey from the Central Railroad Company. As such, they are a part of a long line of litigation which has for several years occupied the Federal Courts and both the judicial and other branches of the State Government.[1]

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[1] See Central Railroad Company of New Jersey v. State Board of Tax Appeals, 109 N. J. L. 395 (S. Ct. 1932); Central Railroad Company of New Jersey v. State Tax Department, 112 N. J. L. 5 (E. & A. 1933), cert. den. 293 U. S. 568;

In order to better understand the present matter it might be well to outline what has gone before.

(A) The State Litigation

In regard to its assessment for the year 1931, the Company complained to the State Board of Tax Appeals as to certain valuations and assessments "because the average rate of taxation for the year 1931 of prosecutor's property is thereby higher than it should be." The Board dismissed the complaint. The Company thereupon appealed to the New Jersey Supreme Court, which refused to disturb the assessment as it stood. The New Jersey Court of Errors and Appeals unanimously affirmed that judgment.

The Company appealed the assessment for the year 1932 to the State Board of Tax Appeals, which, after hearing, affirmed the assessment. There was no attempt to have the judgment reviewed.

The Company also appealed the 1933 assessment to the State Board of Tax Appeals. The Board, after hearing, affirmed the assessment. An appeal was taken to the [fol. 192] Supreme Court, which sustained the Board, holding that the method of assessment was legal and that the Company had not been wronged thereby. Central R. R. *vs.* Thayer-Martin, 114 N. J. L. 69.

The Company appealed the assessments for the years 1934, 1935 and 1936 to the State Board of Tax Appeals urging that: (a) The properties were assessed in excess of their true value; (b) The method of valuing was erroneous and improper; and (c) The assessment of railroad property was discriminatory. The Board, after reviewing extensive evidence as to the above, affirmed the assessments for all three years. There was no appeal from those judgments.

The Company appealed the assessments for the years 1937 and 1938 to the State Board of Tax Appeals. On that

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N. J. Tax Reports, 1912-1934, page 680; N. J. Tax Reports, 1912-1934, page 675; 114 N. J. L. 69; 19 Fed. Supp. 63 (1936); 100 F. 2d 1939 (1938), cert. den., 306 U. S. 651, rehearing denied, 306 U. S. 669; N. J. Tax Reports, 1934-1939, page 82; N. J. Tax Reports, 1934-1939, page 233; 30 Fed. Supp. 41 (1939), rev. 115 F. 2d 968 (1940), cert. den. 313 U. S. 568; 19 N. J. Misc. 427; 20 N. J. Misc. 283; 136 F. 2d 633 (C. C. A. 3, 1943)

appeal, in addition to numerous other points, the Company urged: (a) Deprivation of property without due process of law, in violation of the Fourteenth Amendment to the Federal Constitution: (b) A denial of equal protection of the laws in violation of Article IV, Section 7, Paragraph 12 of the New Jersey Constitution; (c) A denial of equal protection of the laws in violation of the Fourteenth Amendment to the Federal Constitution; (d) A burden upon interstate commerce in violation of Article I, Section 8, of the Federal Constitution. After a lengthy hearing involving some 4600 pages of testimony and 450 exhibits the Board affirmed the assessments. There was no appeal from that decision.

The State Tax Commissioner, after making the 1939 assessments, revised them downward. The City of Jersey City appealed to the State Board of Tax Appeals, which, after a hearing at which the Company, the State and the City of Jersey City adduced testimony, restored the original valuations. 20 N. J. Misc. 283, 26 Atl. (2d) 733. No review of that judgment was sought in the State Courts. As will be mentioned, infra, however, the Bankruptcy Court later set aside the judgment in its Order No. 171; this latter order was itself set aside by the Third Circuit Court of Appeals as reported in 136 F. 2d 633 (1943).

[fol. 193] (B) The Federal Litigation Preceding Bankruptcy

The Company petitioned the United States District Court for the District of New Jersey for a permanent injunction restraining the collection of taxes assessed against it for the years 1932 and 1933. In its petition the Company alleged a denial of due process of law, denial of equal protection of the laws and subjection of interstate commerce to an undue burden. The District Court held that the charges were not established by the evidence and denied the relief sought. 19 Fed. Supp. 63 (1936) (Opinion by Judge Forman). The Company appealed to the Circuit Court of Appeals for the Third Circuit which affirmed the judgment of the District Court. 100 F. 2d 139. (Opinion by Judge Biggs.) The Court held, inter alia, that the evidence had not supported the Company's allegations and that the question of violation of Federal Constitutional guarantees was res adjudicata, having been decided by the

New Jersey Supreme Court in 1933 in the case of Central Railroad *v.* Thayer-Martin, 114 N. J. L. 69, supra. The United States Supreme Court denied certiorari. 306 U. S. 651, rehearing denied, 306 U. S. 669 (1939).

The Company again brought suit in the Federal District Court seeking an injunction against the collection of the taxes as assessed for 1934, 1935 and 1936. The District Court sustained most of the Company's contentions and issued an injunction prohibiting the State from collecting more than 60% of these taxes until the property in question should be re-valuated in a manner consistent with the opinion of the District Court. 30 Fed. Supp. 41 (Opinion by Judge Forman). The injunction was later modified to 70% The Circuit Court of Appeals reversed that judgment. 115 F. 2d 968 (C. C. A. 3) (Opinion by Judge Maris). The Court held that the evidence did not establish the contentions of the Company and that the question of the validity of New Jersey's method of taxing railroad property was res adjudicata by virtue of Central Railroad *v.* Thayer-Martin, 114 N. J. L. 69, supra.

[fol. 194] (C) Federal Litigation after Bankruptcy

On October 30, 1939, the Central Railroad Company filed its petition under Section 77 of the Bankruptcy Act. The Company then owed balances on its taxes for the years 1932 to 1939 inclusive. The Comptroller of New Jersey filed proofs of claim for those taxes with the Bankruptcy Court, and, notwithstanding the decisions of this Court adverse to the Company as reported in 100 F. 2d 139, cert. denied 306 U. S. 651, and 115 F. 2d 968, cert. denied 313 U. S. 568, the Trustees of the Debtor once again raised the same issues as to the same years, before the Bankruptcy Court.

Meanwhile, the New Jersey Legislature passed the so-called Settlement Acts, which sought to forgive the railroads part of their indebtedness to the State. These Acts were contested by the Attorney General of New Jersey and declared unconstitutional by the New Jersey Supreme Court, 133 N. J. E. 447, affirmed by the Court of Errors and Appeals, 135 N. J. E. 244. While this litigation was pending the Bankruptcy Court issued its Order No. 163, fixing the amount due the State from the Debtor as the amount fixed in the Settlement Acts. On appeal to this Court, Order No. 163 was set aside. In re Central Railroad, 136 F. 2d 633. (Opinion by Judge Maris).

On August 12, 1944, following the decision of the New Jersey Court of Errors and Appeals declaring the Settlement Acts unconstitutional, the Trustees petitioned the Bankruptcy Court to adjudicate "the relative rights, claims, liens and priorities" in the assets of the Debtor. The State, through its Attorney General, appeared specially and moved for the dismissal of the petition "insofar as the liens of the State for taxes and interest are sought in anywise to be altered, affected, modified or destroyed," contending that the Bankruptcy Court was without jurisdiction, in the premises, to bind the State in that matter. The Bankruptcy Court refused to pass on this jurisdictional question, referring it, together with the matters which had already been extensively litigated as outlined above, to a Special Master. The Court did this in its Order No. 250, from which an appeal is pending in this Court.

[fol. 195] The Special Master started hearings on December 19, 1944. The Master did not seem to be disposed to hear argument on the jurisdictional question but upon protest by the State he did so. Upon conclusion of the argument he stated that he would proceed the following day with a hearing on the merits, before he decided the jurisdictional matter. On January 17, 1945 he filed an interim report, stating that the Bankruptcy Court is "the proper Court to determine the validity and amount of the tax claims of the State of New Jersey and the incidental liens alleged to affect the property in the custody of the Court." The State thereupon protested that the Master had not squarely met its objections to the jurisdiction of the Bankruptcy Court. On February 7, 1945 the State requested a decision on this matter from the District Judge. Notice was then given that the hearing would proceed before the Master; the State again protested that no hearing should be had on the merits until the District Judge had decided the question of jurisdiction. On February 20th these arguments were made to Judge Fake and the next day the Judge informed the State that he had determined he did have jurisdiction. He made a finding confirming the Master's interim report.

The State thereupon petitioned this Court, praying for a writ of prohibition forbidding the Bankruptcy Court from making any adjudication in connection with the tax liens of the State that was intended to be binding on the

State. That petition is one of the matters now before us. In the meantime, the District Court, again over the strenuous objections of the State, issued its Order No. 271 confirming the Master's Report. The State has appealed from Order No. 271 and that appeal is also before us.

The problem confronting us is substantially: Whether a District Court, in the course of its general supervision of a Section 77 Debtor, can make an adjudication concerning the validity of tax liens which had attached to the property of the Debtor prior to the filing of the petition in Bankruptcy, when those assessments upon which the liens are based have previously been held valid upon appeal by the taxing authority of a State and when the highest Court [fol. 196] of the State and the United States Circuit Court of Appeals have previously held the method of assessing those taxes to be legal and valid, and

If the above question is answered in the affirmative, what limitations exist upon the power of the Bankruptcy Court to so adjudicate.

Analysis of New Jersey's Method of Taxing Railroad Property During the Taxable Years

(1) Method of assessing the taxable property.

The laws of New Jersey in effect during the taxable years in the instant case provided substantially as follows:

Throughout our discussion of the New Jersey taxing machinery reference is made to statutes, some of which represent amendments made as late as 1933. Although these amendments were made later than the first taxable year, 1932, it is not deemed necessary to note the changes from the former law, since in every case the rights of the taxpayer on the one hand and the duties of the taxing authorities on the other, were substantially the same throughout the taxable period.

The Statutes of New Jersey provided that all the property of a railroad not used for railroad purposes should be assessed and taxed by the same assessors, in the same manner and at the same rate as the taxable property of other owners in the same taxing district.[2] All property of a

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[2] N.J.S.A. 54:20-1*

* Indicates statute repealed by L. 1941, c. 291, p. 798, Section 75. Effective July 22, 1941.

railroad used for railroad purposes was to be assessed and taxed by the State Tax Commissioner.[3] It was provided that the State Tax Commissioner should sit at the State Capitol on the first Tuesday of March in each year and as often during the year and at such places as his duties should require for the purpose of ascertaining the true value, as of the first day of January preceding, of all the property of each railroad used for railroad purposes [fol. 197] in the state, including its franchises.[4] The Commissioner was required to ascertain: (I) The length and value of the main stem in each taxing district; (II) The value of the other real estate used for railroad purposes in each taxing district in the state, including the roadbed (other than the main stem), tracks, buildings and all other real estate except lands not used for railroad purposes; (III) The value of all the tangible personal property of each railroad company, and (IV) The value of the remaining property, including the franchise. He was required to complete these valuations by the first day of November following, and on or before December tenth next following he was required to serve upon the treasurer of each railroad company or leave at his office a statement of the assessed valuation of the property of such company in the state and of the separate valuation of the property of such company in each taxing district.[5] The assessors of all taxing districts where property of a railroad not used for railroad purposes should be assessed, if required to do so by the Commissioner, were to certify and send to the Commissioner on or before the second Monday in June following the first day of January as of which the property was valued, a statement giving the description of such property and showing the assessed valuation thereof. They were required, at the same time, to certify and send him a short description of all the real property in their respective taxing districts, used or owned for railroad purposes excepting the main stem or roadbed and track not exceeding one hundred feet in width of each railroad.[6] The assessors were also required to certify to

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[3] N.J.S.A. 54-20-2*

[4] N.J.S.A. 54:22-1*

[5] N.J.S.A. 54:22-1*

[6] N.J.S.A. 54:22-3*

the Commissioner the local rate of taxation for county and municipal purposes as soon as it should have been determined, and such other information obtained in the course of the performance of their duties as the Commissioner should require of them.[7] In order to obtain the facts neces- [fol. 198] sary for the discharge of his duties the Commissioner was empowered to use any lawful means he deemed necessary. Thus he was empowered to employ surveyors if dissatisfied with information otherwise obtainable, and could employ such assistants in making his valuations as should be necessary to complete them in due time.[8] Each company running, operating or constructing a railroad in New Jersey was required on or before March first in each year to return to the State Tax Commissioner statements or schedules showing its property as it existed on the first day of January preceding; the information required in this statement was very extensive and exhaustive, but it need not be gone into in detail here.[9] If the returns were not made the Commissioner was required to ascertain the necessary facts from the best information he could obtain and in such manner as he should find convenient, using his personal knowledge and judgment.[10] Upon his completion of the valuation of the property described in subdivisions I, II, and IV, supra, pages ——, the Commissioner was required to assess such property and proceed to compute the tax thereon at the "average rate of taxation."[11] This "average rate of taxation" was computed in the following manner: On or before April first in each year the assessor in every taxing district was required to prepare and forward to the State Tax Commissioner a certificate, under his hand and seal, duly sworn to under oath, certifying to the Commissioner the true value of all property, real and personal, located in his taxing district, other than the property of railroad and canal companies the taxation of which was provided for in the Statutes here analyzed but including therein the assessed value of railroad and canal companies particularly

[7] N.J.S.A. 54:22-4*
[8] N.J.S.A. 54:22-5*
[9] N.J.S.A. 54:23-1*
[10] N.J.S.A. 54:22-5*
[11] N.J.S.A. 54:24-2*

described in Subdivision II, supra, page , and he was required also to certify and report the rate of taxation in his taxing district for that year. The aggregate value of all the property, real and personal, so certified, was deemed to be the aggregate value of the general property in the [fol. 199] state. In each taxing district the amount obtained by multiplying the value of all the property in the taxing district by the rate of taxation therein was deemed to be the total taxes of the taxing district, and the aggregate of the total taxes so ascertained was deemed to be the aggregate taxes of the state. The "average rate of taxation" was computed and determined by the Commissioner by dividing the aggregate taxes by the aggregate value of the general property in the state. The rate so arrived at and determined was entered upon the records of the State Tax Department and constituted the "average rate of taxation" for that year.[12] If an assessor in a taxing district failed to make the required certificate, the State Tax Commissioner was required and empowered to ascertain, in such manner as he deemed most practicable, the aggregate value of all the property in the taxing district required to be included in such certificate and the total taxes in such district. The amounts fixed by the Commissioner were deemed to stand as the aggregate value and the total taxes for the year for the taxing district.[13] In regard to that type of property classified under subdivision II, page 11, supra, on or before December tenth following the completion of his valuation in each year the State Tax Commissioner was required to certify the value of the real estate used for railroad purposes in each taxing district, classified under subdivision II, to the county boards of taxation in the several counties and to the assessors in the several taxing districts in which the property was situated. The statute so ordering provided that the right of hearing provided by law should in no way be restricted or abridged.[14] The value of the property so certified was required to be included in the amount of ratables to be taxed in the several taxing districts, and the necessary tax rate and the amount of the ratables for such districts were

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[12] N.J.S.A. 54:24-3*

[13] N.J.S.A. 54:24-4*

[14] N.J.S.A. 54:24-8*

required to be ascertained by the county board of taxation in each county and certified to the State Tax Commissioner on or before the first day of April following the receipt [fol. 200] from the State Tax Commissioner of the certificate of values mentioned in the preceding sentence.[15] Upon receipt of the certificate from the county boards the Commissioner was required to include in the taxes to be assessed by him upon the railroad property, payable in that year, a tax upon the property classified under subdivision II, supra, page 11, at the rate in each taxing district so certified by the county boards of taxation and the said property was not subject to any other tax.[16]

(2) Method of Reviewing Assessments by the State Tax Officers

(a) On the first Monday of July after the filing of the returns, the Commissioner was required to sit at the State House at Trenton, and to give all companies interested a hearing, touching the valuation and assessment of their property. He was empowered to adjourn from day to day, and could, if he saw fit, require all arguments and communications to be presented in writing.[17] The Commissioner was further required to sit on the second Monday of January in each year at the State House, Trenton, for the purpose of reviewing his assessments of railroad property made as of January first of the previous year; he was empowered to adjourn from time to time until he should have finished the hearings.[18] Any railroad or the Attorney General on behalf of the state and of the taxing districts, claiming that error had been made in the assessment of railroad property, could, on or before the second Monday of January, file a complaint specifying the grounds of complaint and the relief sought; the State Tax Commissioner was thereupon required by statute to review the said assessment and correct the same as should appear just.[19] Ample provision was made for notice to the interested parties.[20]

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[15] N.J.S.A. 54:24-9*

[16] N.J.S.A. 54:24-10*

[17] N. J. S. A. 54:26-1*.

[18] N. J. S. A. 54:26-2*.

[19] N. J. S. A. 54:26-3*.

[20] N. J. S. A. 54:26-4*.

[fol. 201] The Tax Commissioner on said review was empowered to issue subpoenas and examine witnesses and call for the production of books and papers. Also, he was entitled to use his personal knowledge and judgment as to the value of the property.[21] The Attorney General or his deputy attended the hearings as representative of the State.

(b) Any railroad company, or the Attorney General on behalf of the State, or, in respect to second-class property, the authorities of the taxing district, desiring to contest the final determination of the State Tax Commissioner upon review, or the validity or amount of the tax levied upon the railroad company, or any railroad company or the Attorney General on behalf of the State and of the taxing districts claiming that there had been illegal discrimination in the assessment of any property or in the levying or imposing of the tax thereon, or that there had been illegal discrimination in the assessment of railroad property as compared with the assessment of property generally, could, under the statutes, on or before the third Monday of June following the levying or imposing of the tax, file a written complaint with the State Board of Tax Appeals, specifying the grounds of complaint and the relief sought.[22] Ample provision was made for notice to all interested parties.[23] The State Board of Tax Appeals was required to meet on the third Monday of June in each year at the State House in Trenton for the purpose of fixing a time and place for the hearing of any complaint so filed. The Attorney General or his deputy represented the State at such hearings. If it was made to appear upon such hearing that any such assessment or tax was illegal, excessive, insufficient, or that there had been illegal discrimination in the assessment, the Board was required to correct, adjust and equalize the assessment and tax of such property.[24]

[fol. 202] (3) Judicial Review of Tax Assessments

If any railroad company, or the Attorney General on behalf of the State, or in respect to second-class property,

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[21] N. J. S. A. 54:26-4*.

[22] N. J. S. A. 54:26-7*.

[23] N. J. S. A. 54:26-8*.

[24] N. J. S. A. 54:26-9*.

if the authorities of any taxing district desired to contest the final determination of the State Board of Tax Appeals, such contest could be made under the statutes by certiorari, provided that the application therefor was made within three months from the date of the certification to the State Tax Commissioner of the final determination of the State Board of Tax Appeals.[25] If the Supreme Court allowed the writ to a railroad company, the latter was obligated to pay that portion of the tax not in dispute as a condit-on precedent to prosecuting the writ. The payment of the part in dispute was stayed until the controversy had been determined by the Court. If it was made to appear before the Supreme Court on the writ of certiorari that the final determination of the State Board of Tax Appeals in respect to any such assessment or tax in controversy was illegal, excessive, insufficient, or that there had been illegal discrimination in the assessment, the Court was required by statute to correct, adjust and equalize such assessment and tax or refer the same back to the State Tax Commissioner who was then required to correct, adjust and equalize the assessment and tax in accordance with the instructions or decisions of the Court.[26] The statutes provided that in any suit or proceeding, except on such complaint before the State Board of Tax Appeals or on such certiorari, the certificate and report of the State Tax Commissioner should be conclusive and should have the force and effect of a judgment of a Court of record having competent jurisdiction, and the proceeding whereon such certificate and report were founded should not be inquired into.[27] The judgment of the Supreme Court on certiorari may be reviewed by New Jersey's highest tribunal, the Court of Errors and Appeals.

[fol. 203] **The Applicable Law**

To recapitulate very briefly, certain taxes are allegedly owing the State of New Jersey for the years 1932-1939. Those taxes fell due prior to the petition of the Debtor in bankruptcy. Although there had been a great deal of litigation in the matter antedating the bankruptcy petition, all of which ended finally in decisions against the now Debtor,

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[25] N. J. S. A. 54:26-11*.

[26] N. J. S. A. 54:26-12*.

[27] N. J. S. A. 54:26-13*.

the trustees of the Debtor, after the bankruptcy, petitioned the Bankruptcy Court to determine the validity of these taxes and, in effect, asked that the taxes be materially reduced. As authority for such action by the Bankruptcy Court, they cite Section 64 (a) of the general Bankruptcy Act, 11 U. S. C. Section 104 (a). This section reads, in part, as follows:

> "The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates * * * shall be * * * (4) taxes legally due and owing by the bankrupt to the United States or any State * * *: Provided * * * That, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the [Bankruptcy] court * * *."

The District Court has issued an order confirming a Master's Report, which latter purports to find jurisdiction in the District Court. We are asked to review the legality of that order.

The case of Arkansas Corporation Commission et al. *vs.* Thompson, 313 U. S. 132, is directly in point. It is interesting to note that the Attorney General of New Jersey filed a brief in that litigation as amicus curiae. The question there involved, in the language of the Court, concerned "the right and power of a federal bankruptcy court to revise and redetermine for state tax purposes the property value of a railroad (Missouri Pacific) in reorganization under Section 77 of the Bankruptcy Act, the state (Arkansas) having already determined such value through its own taxing officials and in accordance with the procedure prescribed by [fol. 204] valid state legislation." The District Court held that it did have such power and the Circuit Court of Appeals affirmed. 116 F. 2d 179 (C. C. A. 8). The United States Supreme Court reversed that decision. Mr. Justice Black, speaking for the Court at pages 142 and 145, said:

> "It is thus obvious that the trustees' petition which the bankruptcy court refused to dismiss, rested entirely upon the assumption that Section 64 (a) (4) gave the bankruptcy court power to hold a completely new hearing in order to set its own value on the property, regardless of the value fixed by the state through its expert and specially constituted quasi-judicial agency.

"But we do not so interpret Section 64 (a) (4). What Section 64 (a) (4) relates to is 'taxes legally due and owing by the bankrupt.' And what that section further provides is that 'in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court; * * *.' Nothing in this language indicates that taxpayers in bankruptcy or reorganization are intended to have the extraordinary privilege of two separate trials, one state and one federal, on an identical issue of controverted fact—the value of the property taxed. Manifestly, whether or not taxes are 'legally due and owing' to a state depends upon the valid laws of that state. Ad valorem taxes depend upon a determination of value. The governmental function of fixing the value for tax purposes has rarely, if ever, been a judicial function. The 'legality' of the action of Arkansas in entrusting the determination of value to its Corporation Commission is not challenged here, as of course it could not be. If the Commission properly found the value of the property, the 'amount' of the taxes is not in question. For it is not asserted that the Commission made an improper arithmetical computation in applying the legal tax rate to the determined property value."

The Court goes on to distinguish the Arkansas case from the case of New Jersey *vs.* Anderson, 203 U. S. 483, saying:

"But in that case the trustee argued in his brief before this Court that under controlling New Jersey law [fol. 205] 'the assessors acted ministerially, not judicially, their 'determination was merely computation,' and their actions exceeded their statutory authority.

"The Arkansas Corporation Commission, however, does not act ministerially. On the contrary, it is a quasi-judicial agency entrusted with wide responsibilities in connection with the general tax system of the state. Upon it the state relies for the hearing and determination of matters essential to the maintenance and fair functioning of a uniform tax system.

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"If the trustee had availed himself of his right of appeal to the courts of Arkansas, with an ultimate right of appeal to this Court for final determination of federal questions, it is difficult to believe that it would now be seriously argued that Congress, by Section 64 (a) (4), intended to impose upon the bankruptcy court the unusual power and delicate duty of trying out afresh the facts found by the state with relation to the value of property. And there is no more reason to assume that Congress intended that the bankruptcy court should fail to give respect to an unappealed determination of value made by the Arkansas Corporation Commission. Bankruptcy and reorganization proceedings today cover a wide area in the business field. But there is nothing in the history of bankruptcy or reorganization legislation to support the theory that Congress intended to set the federal courts up as super-assessment tribunals over state taxing agencies. The express legislative purpose of Arkansas to move towards a more nearly uniform and fairly distributed tax burden through relying on supervision by a single agency could be in large part frustrated by the construction of the Bankruptcy Act for which the trustee here contends. Section 64 (a), thus construed, would tend to obstruct, and not to facilitate, the enforcement of state tax laws. Nothing in the language of the Act requires such a construction. And the policy of revising and redetermining state tax valuations contended for by the trustee would be a complete reversal of our historic national policy of federal noninterference with the taxing power of the states.

[fol. 206] "For the reasons given, it is our opinion that the District Court should have dismissed the trustee's petition."

The Arkansas opinion was filed in 1941. In 1944 this Court had occasion to interpret that decision in the case of In re Monongahela Rye Liquors, Inc., 141 F. 2d 864 where Judge Jones, for the Court, said at page 868:

"'The view we take of the decision in the Thompson case in that where, after a hearing, a quasi-judicial body, thereunto duly empowered, determines the amount of a tax due, with the right on the part of the

taxpayer to a judicial review of the determination, all conformable with the requirements of due process, such determination, upon becoming final by operation of law, is conclusive upon a court of bankruptcy save for mathematical error in the computation of the amount of the tax or legal error in its assessment. * * *".

The Circuit Court of Appeals for the Second Circuit discussed the Arkansas holding in Lyford *vs.* City of New York, 137 F. 2d 782. Judge Clark said at page 786:

"In that case the Court distinguishes the Anderson case, because in the latter the New Jersey tax assessors acted only in a ministerial capacity while the Arkansas Commission acted in a quasi-judicial capacity and had finally settled the tax upon the participation of the trustee, who then did not take the appeal provided by the State law. Hence in the Thompson case the assessment of the tax had become res adjudicata by virtue of the state proceedings when the bankruptcy court assumed the power to consider it. Moreover, the question involved was that of valuation of the property of the railroad in the state—a matter the courts generally would not review on appeals from administrative bodies and which the court concluded Congress did not intend should be reviewed in bankruptcy. In other words, the decision concerns a tax finally settled without appeal by the state authorities and an attack not on issues of legality, but on issues of valuation. Review in such a case involves the upsetting of state-taxing activities in ways beyond that [fol. 207] permitted as to administrative action generally, as had been pointed out by commentators and as was held by the Supreme Court."

Inherent in all of the decisions is the strong sentiment that the Federal Court should scrupulously refrain from interference with the tax-machinery of a state unless that machinery is serving to deprive a litigant of his federally guaranteed rights. In line with that basic policy Mr. Justice, now chief Justice Stone, in Healy *vs.* Ratta, 292 U. S. 263, a case involving an attempt in the Federal Courts to enjoin the collection of a state tax, says at page 270:

"Due regard for the rightful independence of state governments, which should actuate federal courts, re-

quires that they scrupulously confine their own jurisdiction to the precise limits which the statute has defined. See Matthew *v.* Rodgers, supra, at 525 * * *."

The Rodgers case, cited in Healy *vs.* Ratta, supra, has again been referred to in what is perhaps the most recent re-enunciation of the principles governing federal interference with state tax matters, Lawrence Print Works *vs.* Lynch, 146 F. 2d 996 (C. C. A. 1). There Judge Peters says at page 997:

"The plaintiffs claim to have acquired the right to an abatement of taxes by virtue of an oral agreement with the assessors approved by the tax commission of Massachusetts. The claim was rejected and the right to abatement denied by the defendant board of assessors. It is apparent that the relief sought in this suit,—a compulsory reversal by the assessors of their action in laying taxes on the property of the plaintiffs without an abatement,—is a direct interference with the fiscal affairs of the state, which has been strongly condemned by the Supreme Court. Matthews *vs.* Rodgers, 284 U. S. 521, 525, 52 S. Ct. 217, 76 L. Ed. 447; Commonwealth of Pennsylvania *v.* Williams, 294, U. S. 176, 55 S. Ct. 380, 79 L. Ed. 841, 96 A. L. R. 1166; Great Lakes Dredge and Dock Co. *vs.* Huffman, 319 U. S. 293, 63 S. Ct. 1070, 1073, 87 L. Ed. 1407.

"The opinion in the Huffman case, decided in 1943, contains the following quotation from Matthews *v.* [fol. 208] Rodgers, supra: 'The scrupulous regard for the rightful independence of state governments which should at all times actuate the federal courts, and a proper reluctance to interfere by injunction with their fiscal operations, require that such relief should be denied in every case where the asserted federal right may be preserved without it. Whenever the question has been presented, this Court has uniformly held that the mere illegality or unconstitutionality of a state or municipal tax is not in itself a ground for equitable relief in the Courts of the United States.'"

Comparing the functions of the Arkansas Tax Commission as set out in the Arkansas Thompson opinion with those of the New Jersey tax authorities, we find:

I. "Before entering upon his duties in the assessment of property, each member of the Commission [the Arkansas Commission] must subscribe to an oath that he will well and truly value and assess all property required to be assessed." 313 U. S. 132, at 139.

The State Tax Commissioner of New Jersey was required, before entering upon the duties of his office, to make and subscribe an oath, to be filed in the office of the Secretary of State, "that he will faithfully, impartially, and without fear, favor or prejudice discharge the duties of his office." N. J. S. A. 54:1-4. (This statute was repealed, L 1944, c 112, art. 8, Sec. 10, effective July 1, 1944. The repealer does not concern us.)

Each member of the New Jersey State Board of Tax Appeals was required, before entering upon the performance of his duties, to file with the Secretary of State an oath taken before a Justice of the Supreme Court, that he will faithfully discharge the duties of his office. N. J. S. A. 54:2-5.

II. "The Commission [Arkansas] has full power to summon witnesses and hear evidence, but further, before assessments are finally determined, all persons interested have the right, on written application, to appear and be heard." 313 U. S. 132, at 139.

[fol. 209] The New Jersey State Tax Commissioner was required to hold hearings for all companies interested on the first Monday in July et sequitur, touching the valuation and assessment of their property. N. J. S. A. 54:26-1 (supra page 15). He was further required to hold hearings on the first Monday of January et sequitur for the purposes of reviewing his assessments of railroad property. N. J. S. A. 54:26-2. (Supra, page 15-16). The Tax Commissioner on this review was empowered to issue subpoenas and examine witnesses and call for the production of books and papers. N. J. S. A. 54:26-4 (supra page 16).

Any person feeling aggrieved by the decision of the Commissioner could, upon the filing of a written complaint, appeal his decision to the State Board of Tax Appeals. N. J. S. A. 54:26-7 (supra page 17). That Board was required to grant a hearing to the complaining party and cor-

rect any inequities which were shown to exist. N. J. S. A. 54:26-9 (supra page 17).

III. "The Corporation Commission has been chosen by Arkansas as the ultimate guardian of the rights of the state and its taxpayers, subject only to that judicial review provided for by the state." 313 U. S. 132, at 139.

In New Jersey either the Attorney General on behalf of the State, or any railroad company could appeal any determination of the State Tax Commissioner to the State Board of Tax Appeals, calling upon the latter to adjudicate their respective rights. N. J. S. A. 54:26-7 (supra page 17).

The statutes provided that in any suit or proceeding, except on a complaint before the State Board of Tax Appeals or on certiorari to the Supreme Court, the certificate and report of the State Tax Commissioner should be conclusive and should have the force and effect of a judgment of a Court of record having competent jurisdiction, and the proceeding whereon such certificate and report were founded should not be inquired into. N. J. S. A. 54:26-13 (supra page 19).

[fol. 210] IV. "The Arkansas Corporation Commission • • • is a quasi-judicial agency entrusted with wide responsibilities in connection with the general tax system of the State. Upon it the State relies for the hearing and determination of matters essential to the maintenance and fair functioning of a uniform tax system." 313 U. S. 132 at 144.

The New Jersey State Board of Tax Appeals, if it was made to appear on a hearing that any assessment or tax was illegal, excessive, insufficient, or that there had been illegal discrimination in the assessment, was required to correct, adjust and equalize the assessment and tax of such property. N.J.S.A. 54:26-9 (supra page 17).

From the above and a study of the statutes governing the taxation of railroad property in New Jersey it is evident that both the State Tax Commissioner and the State Board of Tax Appeals functioned in a quasi-judicial manner. Hearings were always available to interested parties, as was the machinery to bring those hearings up to the standard required by due process. In no sense could the duties of the taxing authorities be classed as merely ministerial or arbitrary.

The second requirement of the Monongahela doctrine, that of the availability of judicial review, is equally well satisfied. Any party considering himself aggrieved by the decision of the State Board of Tax Appeals could appeal to the New Jersey Supreme Court by certiorari. N.J.S.A. 54:26-11 (page 18, supra). If any inequity was shown to exist, that Court was required to correct it. N.J.S.A. 54:26-13 (supra page 18). Moreover, the judgment of the Supreme Court could be appealed to the Court of Errors and Appeals.

As we see it, all of the foregoing serves to bring the instant problem within the doctrine of the Arkansas and Monongahela cases. That being so, the only matters left open for the Bankruptcy Court to pass upon are: (1) Mathematical error in the computation of the amount of the tax, or (2) Legal error in its assessment. In re Monongahela Rye Liquors, Inc., supra. On any question, if any, of "legal error in its assessment," we presume that [fol. 211] the District Court will bear in mind our decisions in 100 Fed. 2d 139 and 115 F. 2d 968 holding certain items to be res adjudicata and no longer open to further litigation. Failure of this opinion to touch upon certain points raised by the State of New Jersey is not to be construed as meaning that they are without merit: rather, our decision rend[illegible]s discussion of them unnecessary.

In No. 8889, Order No. 271 of the District Court is reversed. This disposes of the entire matter before us. The application for a writ of prohibition in No. 8861 is therefore dismissed, without costs to either party as against the other.

A true Copy: Teste:

——— ———, Clerk of the United States Circuit Court of Appeals for the Third Circuit.

[fol. 212] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, OCTOBER TERM, 1944

No. 8889

In the Matter of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, Debtor; STATE OF NEW JERSEY, Appellant

JUDGMENT—Filed November 15, 1945

Present: Goodrich, Frank and McLaughlin, Circuit Judges.

On appeal from the District Court of the United States, for the District of New Jersey.

This cause came on to be heard on the transcript of record from the District Court of the United States, for the District of New Jersey, and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the Order No. 271 of the said District Court in this case be, and the same is hereby reversed, with costs.

By the Court, Gerald McLaughlin, Circuit Judge.

November 15, 1945.

[File endorsement omitted.]

[fol. 213] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

No. 8889

[Title omitted]

ORDER DEFERRING ISSUANCE OF MANDATE—Filed November 26, 1945

On motion of Shelton Pitney and Walter P. Gardner, Trustees of The Central Railroad Company of New Jersey, Debtor, Appellees, it is on this 26 day of November, 1945, ordered that the issuance of a mandate in the above entitled cause be and the same is hereby deferred for a period of thirty (30) days from and after the 30th day of November, 1945.

Goodrich, C. C. J.

[File endorsement omitted.]

[fol. 214] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

No. 8889

[Title omitted]

ORDER DEFERRING ISSUANCE OF MANDATE—Filed December 22, 1945

On motion of Shelton Pitney and Walter P. Gardner, Trustees of The Central Railroad Company of New Jersey, Debtor, Appellees, it is on this 22 day of December, 1945, ordered that the issuance of a mandate in the above entitled cause be and the same is hereby deferred for a period of thirty (30) days from and after the 30th day of December, 1945.

Goodrich, C. C. J.

[File endorsement omitted.]

[fol. 215] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

No. 8889

[Title omitted]

ORDER DEFERRING ISSUANCE OF MANDATE—Filed January 18, 1946

It is on this 18th day of January, 1946, ordered that the issuance of a mandate in the above entitled cause be and the same is hereby deferred for a period of thirty (30) days from and after the 21st day of January, 1946.

Goodrich, J.

[File endorsement omitted.]

[fol. 216] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

No. 8889

[Title omitted]

ORDER DEFERRING ISSUANCE OF MANDATE—Filed February 21, 1946

It is on this 21st day of February, 1946, ordered that the issuance of a mandate and time for filing petition for rehearing in the above entitled cause be and the same is hereby deferred for a period of sixty days from and after the 21st day of February, 1946.

Goodrich, C. C. J.

[File endorsement omitted.]

[fol. 217] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, OCTOBER TERM, 1944

No. 8861

[Title omitted]

No. 8889

[Title omitted]

PETITION FOR REHEARING ON BEHALF OF WALTER P. GARDNER, TRUSTEE OF THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, DEBTOR—Filed March 21, 1946

[File endorsement omitted.]

[fol. 218] To the Honorable the Judges of the United States Circuit Court of Appeals for the Third Circuit:

Now Comes your petitioner, Walter P. Gardner, as Trustee of the Central Railroad Company of New Jersey, debtor, who respectfully represents that:

1. Since the opinion of this Court was filed on November 15, 1945, petitioner's co-trustee Shelton Pitney died on January 13, 1946, and the properties of the debtor have

since that date been and now are being operated by your petitioner as sole surviving trustee. Petitioner's time to file this petiton has been duly extended to April 20, 1946.

2. The opinion of this Court said:

> "the only matters left open for the Bankruptcy Court to pass upon are: (1) Mathematical error in the computation of the amount of the tax, or (2) Legal error in its assessment. • • •
>
> "In No. 8889, Order No. 271 of the District Court is reversed. This disposes of the entire matter before us. The application for a writ of prohibition in No. 8861 is therefore dismissed, without costs to either party as against the other."

3. Believing that this Court misconceived the questions involved on this appeal, petitioner directs attention to the fact that the issues before the Court were presented to the court below by the trustees in what they styled a "Petition for Adjudication". This petition did not raise the question of the assessment of taxes or the amount of taxes resulting from the assessment. Three interesting and important questions were raised by this petition: (1) Whether a valid and enforceable contract of settlement of the taxes in arrears had been made with the State of New Jersey by the trustees with approval of the court, pursuant to the Railroad Tax Settlement Act of New Jersey (Chapter 290, P. L. 1941, as amended by Chapter 241, P. L. 1942); [fol. 219] (2) whether the debtor's estate was liable to the State after the petition in reorganization was filed for penalties of twelve per cent per annum fixed by the statute, or for interest at three per cent per annum pursuant to the provisions of the Railroad Tax Settlement Laws; and (3) the Court was asked to determine the relative rights, claims, liens and priorities of the claimants in the assets of the debtor's estate. No one of these matters was decided by the Court on this appeal.

All the questions involved were carefully presented to the Court in the trustees' "Petition for Adjudication Concerning New Jersey State Tax Claims" (App. 55a-79a), and were brought he[illegible] in the appeal from Order 271. The prayer of said petition stated:

> "Wherefore petitioners pray that this Honorable Court, the premises considered, may promptly adju-

dicate (1) whether petitioners entered into a contract with the State of New Jersey, (2) whether such contract is binding on the parties thereto, (3) whether, if not binding on the State, petitioners are nonetheless bound by the prejudicial actions taken by them, (4) if not binding on the parties thereto including petitioners, to what extent, if at all, the proofs of claim of the State of New Jersey should be allowed, (5) what order should in such event be made to restore the equivalent of the *status quo ante* as nearly as may be and (6) what in such event are the relative rights, claims, *liens and priorities* of the claimants in the assets of the Debtor's Estate; and that this Honorable Court may instruct petitioners whether to make on or before December 1, 1944 the additional payment on account of the taxes claimed and the additional interest payment required by Chapter 290 of the Laws of 1941, as amended by Chapter 241 of the Laws of 1942."

[fol. 220] I

The question whether there was a valid contract of settlement between the trustees and the State.

4. Annexed to the Petition for Adjudication aforesaid as an exhibit was the State's proof of claim No. 38 for $12,117,450.68 taxes, plus interest thereon in the sum of $7,732,339.53, plus additional interest on said unpaid taxes from December 1, 1940 to date of payment. Paragraph 10 reads:

"(10) Lien, priority or preferential classification, if any, claimed for the claim, or any part thereof, the reasons therefor and full statement of the facts respecting same:

"The statute of New Jersey provides that these taxes shall be a lien paramount to all other liens upon all the lands and tangible property and franchises of the company in this State (Section 9, Chapter 208, P. L. 1888, as amended and supplemented; Section 54:27-4, Revised Statutes). The lien shall take effect on June 1 of the year in which the tax is payable."

This claim was dated December 10, 1940 and verified by the State Comptroller December 15, 1940 (App. 82a).

5. The Petition for Adjudication in paragraphs 12, 13, 14 and 15 shows that the Governor of New Jersey had appointed a committee to investigate the railroad tax problem, and after that committee filed a comprehensive report the Legislature enacted Chapters 290 and 291 of the Laws of 1941, approved and effective July 22, 1941; that by the provisions of Chapter 290 of the Laws of 1941 the State Treasurer was authorized and required to accept, without interest penalties, instalment payments of the [fol. 221] full balance of the principal amount of the taxes assessed for the years 1932 to 1940, inclusive, which remained unpaid on July 22, 1941, provided that a railroad taxpayer complied with the requirements of Sections 7 and 8 of said Act, which are quoted at page 62a of the Appendix. Paragraph 14 recites that on August 8, 1941 the Bankruptcy Court, after considering said offer of compromise contained in said statute, made and entered its Order No. 123 authorizing the trustees to accept the compromise offered in Chapter 260, P. L. 1941, by agreeing to pay the full unpaid balance of the principal amount of taxes claimed by the State for the years 1932 to 1940, inclusive, as authorized and provided for in said Act, without penalties but with interest at the rate of three per cent per annum computed from December 1, 1940, as required by the terms of said statutory offer.

In paragraph 15 the trustees recite that they caused to be filed with and delivered to the appropriate officers of the State all of the documents and payments required for full compliance by them with the conditions of said statutory offer and the provisions of said Order No. 123; and also caused to be filed with and delivered to the appropriate officers of the State all the documents and payments required for full compliance by the subsidiary roads.

Paragraphs 20 and 21 of the petition show that the trustees fully complied in all respects with Chapter 241 not only as to the taxes assessed by the State against the debtor for 1932 to 1940, inclusive, but also as to all taxes claimed from the trustees on account of taxes assessed against subsidiaries, and waived any and all rights to contest the legality or amount of the retroactive franchise tax for 1941 (im-

posed by said Act), which said tax petitioners paid in good faith and without contest, and for the recovery whereof the laws of the State provide no right or remedy. They also paid, as required, additional interest. They filed and delivered to the appropriate State officers all the [fol. 222] documents and payments required for full compliance by subsidiaries. Among the documents delivered to the State officers were discontinuances of appeals from taxes that were then in litigation.

6. The question presented was a comparatively simple question of bankruptcy law. The Court had control of the debtor and its estate. The State had filed with the Court a claim for large taxes and interest, and by so doing submitted itself and its claim to the jurisdiction of the Bankruptcy Court so far as the claim was concerned. Thereupon, the State Legislature passed a public law, which was approved by the Governor, offering the Bankruptcy Court to compromise the claim in a manner specified by the Act. This compromise need not have been accepted. The Court, however, made an order accepting the offer of compromise and directing its trustees to perform the conditions of the statute. The trustees did comply with the provisions of the statute, as recited in the Petition for Adjudication, paragraphs 14 and 15 (App. 62a-63a), and as directed by the order of the Court. By so doing the trustees gave up valuable rights belonging to the estate, as the Petition for Adjudication shows. In fact, they gave up every right they had further to contest, in any court, the claims for the taxes compromised, and, as the petition shows, they paid in full the franchise taxes for 1941 without contest, and from which they had a right to appeal.

7. All this took place before the Attorney General of the State instituted a proceeding in the Court of Chancery on September 4, 1941, attacking the constitutionality of the Railroad Settlement Act of 1941 (App. 63a, par. 16).

8. It is respectfully submitted that after such contract of settlement was made between the trustees in reorgani- [fol. 223] zation on the one hand, and the State of New Jersey, a creditor of the bankrupt which had appeared in the reorganization proceedings prosecuting its claim on the

other hand, with court approval, the only way in which said contract could be abrogated and set aside was on appeal to this Court and thence to the Supreme Court of the United States.

9. It is submitted that this contract is still in full force and effect. The trustees have scrupulously made tender to the State of each and every payment required by the settlement to this date, and in no respect is the debtor's estate or the trustee in default.

10. This Court, in *In re Central R. Co. of N. J.*, 136 Fed. (2d) 633 (decided before *Wilentz* v. *Hendrickson* was decided in the State Courts), reversed Order No. 163 signed by Judge Fake which adjudicated the amount of the State's claims and made them payable in the manner, at the times, with interest, and upon the terms and conditions prescribed by Chapter 241, P. L. 1941. This decision was on the ground that this order was based upon the assumption that the Tax Settlement Acts are valid, and was in no manner conditional upon the final outcome of the suit in the State Court. This Court, however, said that since the State law directed that the steps to comply with the Tax Settlement Acts must be taken on or before June 15, 1942:

> "It is vitally important to the Debtor in case the constitutionality of the Tax Settlement Acts is ultimately sustained, that the tenders made by the trustees prior to that date, pursuant to the directions of Order No. 163, be not invalidated by the reversal of that order. Accordingly so much of paragraphs 6 and 7 of Order No. 163 as authorizes the trustees to comply with the requirements of the Tax Settlement Acts will not be disturbed. • • •
>
> [fol. 224] "Order No. 163, insofar as it determines the tax liability of the Debtor to the State of New Jersey for the years 1932 to 1939 inclusive, and the validity of the Railroad Tax Settlement Acts, and Order No. 171 are reversed and the cause is remanded with directions to the District Court to await the determination by the Court of Chancery of the State of New Jersey of the constitutionality of the Railroad Tax Settlement Acts, unless it finds that delay which may be harmful to the Debtor and its creditors may result,

in which event it may proceed itself to hear and decide the constitutional issue."

Your Honors' opinion in the above case was filed May 27, 1943, and a rehearing was denied July 15, 1943. Five days later Vice Chancellor Jayne filed his opinion in the Court of Chancery holding that the Railroad Settlement Acts were unconstitutional under the title: *Wilentz* v. *Hendrickson*, 133 N. J. Eq. 447. This case was taken to the Court of Errors and Appeals, which filed its decision June 22, 1944, affirming the Court of Chancery, *Wilentz* v. *Hendrickson*, 135 N. J. Eq. 244. Within two months the trustees filed their "Petition for Adjudication" below which, among other things, raised the novel question as to the binding effect of the acceptance of the provisions of the State Act by the trustees under court order before the constitutionality of the Act was questioned where a valid consideration passed in the acceptance of the settlement, and where the *status quo ante* could not be restored.

The Court of Errors and Appeals held that the Railroad Tax Settlement Acts contravene Article 1, paragraph 20 of the New Jersey State Constitution, which provides:

"No donation of land or appropriation of money shall be made by the State or any municipal corporation to or for the use of any society, association or corporation whatever."

[fol. 225] But the opinion stated:

"Thus if the State has a vested right in and to the tax debt (delinquent interest) then unless the remission, cancellation and abatement of that right is supported by a 'legal, equitable or moral consideration' (In re Voorhees, supra), the challenged statutes clearly contravene, in spirit and in fact, the constitutional limitation (Article 1, paragraph 20) invoked."

The court found in said case, in which neither the Central Railroad Company of New Jersey nor its trustee was a party, that there was nothing in the proofs before the court "to support a moral or equitable consideration".

There was, however, ample consideration to support the settlement between the Central Railroad and its trustees and the State. The Reorganization Court, which had juris-

diction of the debtor's estate and the claim of the State, by its orders above referred to made the agreement of settlement an accomplished fact.

11. *Wilentz* v. *Hendrickson* is not *res judicata* on the question presented by the trustees' petition to the court below or in this Court, nor does it have the support of the doctrine of *stare decisis* under the rule in *Erie Railroad* v. *Tompkins*, 304 U. S. 64, for the reason that the *Wilentz* case was tried on *ex parte* affidavits and on an agreed statement of facts, was between the Attorney General of the State as complainant and the State Treasurer as defendant, and resulted in a decree restraining the State Treasurer from complying with the Act. Justice Pitney, speaking for the New Jersey Supreme Court in *Rutten* v. *Paterson*, 73 N. J. L. 467, 475, said:

> "A decision based upon stipulated facts that results in declaring a law unconstitutional does not wipe the act from the statute books, but merely denies its efficacy to a party who had admitted the existence of [fol. 226] a state of facts that in the opinion of the court renders the law unconstitutional."

The opinion of the Court of Errors and Appeals was more in the nature of an advisory opinion:

See Annotated Cases, 1917a, 495, 496 and 497.

In re Opinion of the Justices, 266 Mass. 590, 165 N. E. 904.

"Consideration of Facts in Constitutional Cases" by Hon. Emmet H. Wilson, 17 S. Cal. Law Review 335.

Prall v. *Burckhartt*, 299 Ill. 19; 132 N. E. 280.

That the Act might be held unconstitutional in the contest between two State Officers and yet be constitutional as to the Central Railroad Company of New Jersey is indicated by the severability clause of the Railroad Tax Settlement Act, as amended by Chapter 241 of the Laws of 1942, 58 N. J. S. A. Cum. Poc. Supp. App. 4-7.1 *et seq.*, App. 4-7.16:

> "If any provision of this Act or the application thereof to any person or circumstances is held invalid, the remainder of this Act, or the application thereof to other persons or circumstances shall not be affected thereby."

In *J. A. Dougherty's Sons* v. *Commissioner of Internal Revenue*, 121 Fed. Rep. (2d) 700, this Court said:

> "Although it was formerly held that an unconstitutional statute is a *nullity ab initio* (see Norton v. Shelby County, 118 U. S. 425 and Chicago, Indianapolis & Louisville Ry. Co. v. Hackett, 228 U. S. 559, 566), more lately it has ben recognized that the consequences of action taken or restricted in obedience to the requirements of a statute which subsequently is declared un- [fol. 227] constitutional are to be appraised and adjudged in the light of the compulsion exercised by the statute prior to its determined invalidity. * * * The actual existence of a statute, prior to such a determination, is an operative fact and may have consequences which cannot justly be ignored."

See, also, *Chicot County Drainage Dist.* v. *Baxter State Bank*, 308 U. S. 371, 374.

It would seem, therefore, that neither the decision of this Court in *In re Central R. R. Co.*, 126 Fed. 633, nor the decision of the New Jersey courts in *Wilentz v. Hendrickson*, 135 N. J. Eq. 244, operates to bar an adjudication of the question presented by the trustees' Petition for Adjudication.

12. It is respectfully submitted that the question whether or not the State of New Jersey is legally obliged to accept payment of debtor's taxes in arrears in instalments over a period of years, with interest at three percent per annum on unpaid instalments pursuant to the provisions of the Railroad Tax Settlement Acts, was properly presented to the Bankruptcy Court in the petition of the trustees for adjudication above mentioned, for one of the prime duties of the Bankruptcy Court is to determine the nature, validity and extent of claims against the debtor's estate.

Sec. 2a(2), Bankruptcy Act, 11 U. S. C. A. 11A2.
Sec. 57, Bankruptcy Act, 11 U. S. C. A. 93.

By reversing Order 271 this Court has foreclosed the Bankruptcy Court from passing upon this vital question.

[fol. 228] II

The question of the nature and extent of the State's liens against the property of the debtor.

The sixth prayer of the Petition for Adjudication was:

> "What, in such event, are the relative rights, claims, *liens* and *priorities* of the claims in the assets of the debtor's estate?"

We are confident that your Honors by your decision did not mean to rule that the District Court cannot determine the nature and extent and priority of the lien of the State for taxes. Nevertheless the language of the opinion is that "the only matters left for the Bankruptcy Court to pass upon are: (1) Mathematical error in the computation of the amount of the tax, or (2) legal error in its assessment."

The properties of the Central Railroad Company of New Jersey are located in both New Jersey and Pennsylvania. There is a $50,000,000 issue of bonds held by the public, secured by mortgage upon the debtor's real and personal property and franchises located in both New Jersey and Pennsylvania.

The New Jersey taxes are probably a lien upon the real estate of the debtor located in New Jersey, under Rev. Stat. 54:27-4, which reads as follows:

> "If the taxes of any company, or any portion thereof, remain unpaid on December first following the levying thereof, the company shall be considered in default, and such taxes, or the unpaid portion thereof, shall thenceforth bear interest at the rate of one per cent for each month until paid, notwithstanding the prosecution of a writ of certiorari or other remedy. These taxes shall [fol. 229] be a lien paramount to all other liens upon all the lands and tangible property and franchises of the company in this state. The lien shall take effect on June first of the year in which the tax is payable and shall be a debt due from the company to the state on that date for which an action at law or suit in equity may be maintained, and shall be a preferred debt in case of insolvency. These remedies are in addition to the special proceedings provided for in chapters 19 to 29 of this title (§54:19-1 et seq.)."

Since there was no levy upon or sale or seizure of the personal property of the debtor in the State of New Jersey by the State of New Jersey before the filing of the petition

for reorganization, and the appointment of the trustees, it is probable that the lien of the bondholders is prior to the claims of the State as to tangible and intangible personal property of the debtor located in New Jersey.

Bankruptcy Act, Section 67, 11 U. S. C. A. 107b and c (Pamphlet Section).

Bankruptcy Act, Section 64, 11 U. S. C. A. 104a1 and 2 (Pamphlet Section).

New York v. *Maclay*, 288 U. S. 290.

United States v. *Texas*, 314 U. S. 480.

City of New Orleans v. *Harrell*, 134 Fed. (2d) 399; C. C. A. 5th, 1943.

City of New York v. *Hall*, 139 Fed. (2d) 935; C. C. A. 2nd, 1944; Fank, J.

In re Pennsylvania Central Brewing Co., 114 Fed. (2d) 1010; C. C. A. 3rd, 1940; Biggs, J.; cert. den. 312 U. S. 685.

Sections 64 and 67 of the Bankruptcy Act are applicable to railroad reorganizations under Section 77.

Lyford v. *New York*, 140 Fed. (2d) 840; C. C. A. 2nd, 1944.

[fol. 230] It is thoroughly settled that only the Bankruptcy Court can determine the nature and extent of the liens against the debtor's estate and the priorities as between claimants.

Sec. 67, Bankruptcy Act, 11 U. S. C. A. 107.

City of New York v. *Hall, supra.*

Did your Honors, by your opinion intend to deny to the court below the right to pass upon the nature and extent of the liens of the State of New Jersey for taxes as against the bondholders under the mortgage? This is extremely important in this case where the bond issue is $50,000,000, interest thereon in arrears is $15,000,000, principal of taxes in arrears is approximately $13,000,000 (App. 55a), and interest and penalties to date at one per cent per month are approximately $16,000,000.

III

The Question of Interest and Penalties

Another interesting and important question incidentally raised by the Petition for Adjudication aforesaid is whether

the Bankruptcy Court must determine that the interest and penalties of twelve per cent per annum are collectible by the State as interest, or may reduce it to a modest rate on the ground that this is a penalty. The answer to this question must be in the affirmative. Sec. 57j, Bankruptcy Act, 11 U. S. C. A. 93J.

When it is considered that under a reorganization plan the State may be obliged to take a new issue of first lien bonds on the New Jersey real estate, and that holders of the presently outstanding bonds may have to take second lien bonds on a part of the property and first lien bonds on all other properties of the road, the importance of these questions becomes apparent.

[fol. 231] The Issues Argued on the Petition for Adjudication

When the Attorney General of New Jersey was served with the petition for adjudication he filed a special appearance and objected to the petition being entertained by the court on the ground that it constituted the prosecution of a suit, claim or demand against the State (App. 100a). He asserted in paragraph 3 that the petition appears to invoke the supposed jurisdiction of the District Court to enter determinations and adjudications which may affect, modify, impair or destroy the tax obligations to the State *"and the liens of the State therefor"* (App. 102a). He thereupon moved that the court dismiss the petition insofar as it prayed for an adjudication or determination that the claims for taxes are less than the sums assessed against the debtor, "and insofar as the liens of the State for such taxes and interest are sought in any wise to be altered, affected, modified or destroyed by any such adjudication or determination." Upon the filing of this special appearance of the Attorney General, and after a hearing held October 16, 1944, Judge Fake on motion of the trustees made an Order No. 250

> "That all tax claims filed by the State of New Jersey, the Trustees' objections thereto and the State's reply to said objections, and also the aforesaid purported special appearance of the State objecting to the jurisdiction of this Court filed herein on August 28, 1944 be and the same are hereby referred and re-referred to Augustus C. Studer, Jr., Esq., as Special Master, for hearing and report thereon." (App. 104a)

The Attorney General, on October 30, 1944, served on the debtor and its trustees, the trustee under its mortgage and the bondholders committees, a notice of appeal (App. 106a) to this Court from said order of reference made by [fol. 232] Judge Fake on October 16. The Special Master, on December 19, 1944, held a hearing on the said petition for adjudication and the special appearance of the Attorney General aforesaid, and on January 17, 1945, filed an interim report to the District Court in which he reported that in his opinion the entire property of the Railroad is *in custodia legis*, subject, however, to such rights as are given by law to lien holders. He further held and reported that the Bankruptcy Court is the proper court to determine the validity and amount of the tax claims of the State and the incidental liens alleged to affect the property in the custody of the court. He concluded with the statement:

> "It is the opinion of the Master that the claim of the State to sovereign immunity should be denied and that the petition of the Trustees should not be dismissed." (App., Interim Report, 148a-164a.)

The Attorney General, on January 27, 1945, filed objections on behalf of the State to the interim report of the Special Master, again urging:

> "In the present case the State has not voluntarily submitted its lien claims for enforcement or adjudication in the Bankruptcy Court nor has it lawfully been made a party. Nor can it be made a party to said proceedings without its consent with respect to such liens." (App. 165a-174a.)

On February 7, 1945, a hearing was held by Judge Fake on a motion of the trustees for an order confirming the Interim Report of the Special Master and the objections of the State, and on February 21, 1945, Judge Fake filed his opinion confirming the Special Master's Interim Report and holding that the District Court has jurisdiction of the questions presented by the petition for adjudication (App. 175a-176a).

[fol. 233] Order No. 271, dated March 5, 1945, overruled the objections of the State to the interim report of the Special Master dated January 17, 1945, and adopted it. (App. 177a-179a.)

On April 2, 1945, the Attorney General of New Jersey appealed to this Court from the whole of Order No. 271. In his statement of points on appeal the Attorney General alleged: (1) That the District Court erred in determining that the Bankruptcy Court had the power to make adjudications binding upon the State concerning statutory liens that were affixed in and to the property of the debtor as of the date of the filing of the petition in bankruptcy without the consent of the State; (3) that the Court erred in failing to hold that the Bankruptcy Court was without jurisdiction to make adjudications binding upon the State concerning the statutory liens of the State that were affixed at the time of the institution of the bankruptcy proceedings. (App. 181a.)

State's Petition for a Writ of Prohibition

On February 26, 1945, four days after Judge Fake filed his opinion overruling the Attorney General's objections to the Special Master's interim report, the State of New Jersey by its Attorney General prepared a petition to this Court for a writ of prohibition, addressed to the District Judge and the Special Master, to prevent them from proceeding with the determination of any matters or the making of any adjudication in connection with the tax debt liens of the State for the years 1932 to 1939 inclusive, in and upon the lands, tangible personal property and franchises of the Central Railroad Company of New Jersey, debtor, presently undergoing reorganization proceedings under Section 77 of the Bankruptcy Act (App. 12a-26a).

Upon the filing of this petition with this Court, his Honor, Judge Biggs, on March 9, 1945 (four days after the making [fol. 234] of Order No. 271 overruling the objections of the State to the interim report of the Special Master), granted a rule upon Judge Fake and the other Judges of the District Court and upon the Special Master to show cause why a writ of prohibition should not be issued as prayed for (App. 27a).

Under date of April 2, 1945, Judge Fake filed an answer in response to the order of this Court aforesaid in which he pointed out that the narrow jurisdictional issue presented to him was whether the proceeding on the petition for adjudication of the trusters amounted to a suit against the State of New Jersey. He pointed out that the State had filed in the reorganization proceeding proofs of claim

for its taxes; that objections thereto had been filed by the Trustees to which the State had filed its reply, and that he had referred all disputed claims to the standing Special Master together with all objections thereto for hearing and report.

Paragraph 9 of Judge Fake's answer points up the matter really in issue, which is as follows:

> "9. No party to the proceedings has challenged the principle of sovereign immunity or the principle that the custody and title of the Trustees of the Debtor of and to the estate *in custodia legis* is subject to pre-existing liens. However, the added and extended concept advanced on behalf of the State has been challenged, viz., the concept that the estate *in custodia legis* consists of 'only the interest of the Debtor *over and above*' liens and that 'the court has only that equity which the Debtor had immediately prior to the inception of the proceedings.' It is that argument or concept which has been rejected by said Order No. 271 and, as well, the assumption that the quantum, rank and extent of security of a lien claim asserted by a state must be accepted and the lien claim allowed exactly as [fol. 235] set forth by the State in its proof of claim and without any scrutiny or determination by the Bankruptcy Court of any issues raised with respect thereto by the Trustees and other parties to the reorganization proceedings."

Conclusion

It is respectfully submitted that the two proceedings taken by the Attorney General, which may well be termed "red herring" proceedings, have succeeded in diverting attention from the real questions involved in this case. Those proceedings were: (1) The special appearance of the Attorney General and his contention that a proceeding in the Reorganization Court to determine the nature and extent of the State lien for taxes and the priorities as between claimants is in fact a suit against the State without its consent; and (2) the petition for a writ of prohibition to forbid the District Court from making an adjudication concerning the tax liens of the State.

The opinion of your Honors, filed November 15, 1945, appears to treat the appeal as *involving the amount of the*

assessments and resulting taxes rather than the nature and extent of the liens of the State and the priority of the State's liens over other liens, *i. e.*, mortgage bonds.

The opinion of the Court filed on November 15, 1945, is divided into the following headings:

"(a) The State Litigation.

(b) The Federal Litigation preceding Bankruptcy.

(c) Federal Litigation after Bankruptcy.

Analysis of New Jersey's Method of Taxing Railroad Property during the Taxable Years.

1. Method of Assessing the Taxable Property.

2. Method of Reviewing Assessments by the State Tax Officers.

[fol. 236] 3. Judicial Review of Tax Assessments.

The Applicable Law."

Since the Court treated this appeal in its opinion as one involving the assessment and amount of taxes, which were not involved, and completely disregarded the questions presented by the petition for adjudication, we respectfully pray that a rehearing may be granted, to the end that these most important questions in the reorganization proceedings may speedily be determined, in accordance with the prayer of the trustees' petition for adjudication.

Dated, March 20, 1946.

Respectfully submitted, Walter P. Gardner, Trustee.

James D. Carpenter, Jr., of Counsel, P. O. Address, 75 Montgomery Street, Jersey City, N. J.

Certificate of Counsel

I, James D. Carpenter, Jr., appointed by Order of the District Court dated February 26, 1946, as counsel for the Trustee herein, do hereby certify that the foregoing petition for a rehearing is presented in good faith and not for delay.

James D. Carpenter, Jr.

[fol. 237] IN UNITED STATES CIRCUIT COURT OF APPEALS, FOR THE THIRD CIRCUIT

No. 8861

[Title omitted]

No. 8889

[Title omitted]

ORDER DENYING PETITION FOR REHEARING—Filed March 28, 1946

Present: Goodrich, Frank and McLaughlin, Circuit Judges.

The petition for rehearing in these cases is denied.

By the Court, McLaughlin, Circuit Judge.

March 28, 1946.

[File endorsement omitted.]

[fol. 238] UNITED STATES OF AMERICA,
Eastern District of Pennsylvania,
Third Judicial Circuit, Set.:

I, Wm. P. Rowland, Clerk of the United States Circuit Court of Appeals for the Third Circuit, do hereby certify the foregoing to be a true and faithful copy of the original Appendix to Appellant's Brief, as constituting the portions of the record before this court at argument; and proceedings in this court, in the Matter of Central Railroad Company of New Jersey, Debtor, Appeal of the State of New Jersey, No. 8889, on file, and now remaining among the records of the said Court, in my office.

In Testimony Whereof, I have hereunto subscribed my name and affixed the seal of the said Court, at Philadelphia, this 9th day of April in the year of our Lord one thousand nine hundred and forty-six, and of the Independence of the United States the one hundred and seventieth.

Wm. P. Rowland, Clerk of the U. S. Circuit Court of Appeals, Third Circuit. (Seal.)

[fol. 238a] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed June 10, 1946

A petition for rehearing having been filed in this case upon the denial of a petition for writ of certiorari;

Upon consideration thereof, it is ordered by this Court that the petition for rehearing be, and the same is hereby, granted.

And it is further ordered that the order of May 20, 1946, denying certiorari be, and the same is hereby, vacated; and that the petition for writ of certiorari herein be, and the same is hereby, granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Mr. Justice Jackson took no part in the consideration or decision of this application.

[fol. 239] IN THE SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1946

No. 92

STIPULATION AND ADDITION TO RECORD—Filed August 1, 1946

It is hereby stipulated and agreed by and between the Debtor-Petitioner, through his attorney, James D. Carpenter, Jr., and The State of New Jersey, a Creditor, through its Attorney General, Walter D. Van Riper, by Benj. C. Van Tine, Deputy Attorney General, that the annexed portions of the record in the District Court of the United States for the District of New Jersey, in the proceedings for the reorganization of The Central Railroad Company of New Jersey, No. 29,778, shall form a part of the record in the above entitled appeal under a stipulation between the said parties set forth in the record below at pages 180a to 188a, inclusive,

1. Petition for an Order of Approval under Section 205 Title 11, United States Code, and for further relief, verification omitted.

2. Order No. 3 restraining David T. Wilentz, as Attorney General from entering judgment and issuing execution for collection of taxes for the years 1932 and 1933.

3. Petition for Order No. 7 instructing Debtor whether it should pay any part of the taxes assessed against its property by the State of New Jersey for the years 1939 and if so what part, verification omitted.

4. Affidavit in support of Petition for Order No. 7.

[fol. 240] 5. Order No. 7 to show cause why an Order should not be entered instructing Debtor whether it should pay any part of the taxes assessed against it by the State of New Jersey for the year 1939 and if so what part.

6. Parts of Minutes of Hearing before Hon. Guy L. Fake, U. S. D. J., December 13, 1939, pages 173 to and including first three lines at top of page 195.

7. Order No. 11 directing Debtor to pay $2,049,553.23 on account of taxes assessed against its property by the State of New Jersey for the year 1939.

8. Petition for Order No. 53 authorizing the Trustees to pay monthly installments on account of taxes assessed against property of the Debtor by the State of New Jersey for the years 1932 and 1933.

9. Minutes of Hearing before Hon. Thomas Glynn Walker, U. S. D. J., on June 12, 1940.

10. Order No. 53 authorizing the Trustees to pay monthly installments on account of taxes assessed against property of the Debtor by the State of New Jersey for the years 1932 and 1933.

11. Petition for Order No. 66 fixing the time within which and prescribing the manner by which claims of creditors shall be filed.

12. Parts of Order No. 66 fixing the time within which and prescribing the manner by which claims of creditors shall be filed, all of page 1049; paragraphs 1 and 3 on pages 1050 and 1051; paragraph 8, including Judge's signature and date of order, on page 1054.

13. Parts of Order No. 93 allowing certain claims and referring to Special Master certain disputed

claims and the objections thereto, and referring the question of priority of claims, pages 1487 and 1488 at middle of page; paragraphs 8, 9, 10, 11 and 12, including Judge's signature and date of order on pages 1492 and 1493.

14. Petition of Trustees for instructions concerning payment of certain taxes levied by the State of New Jersey, and for show cause order thereon No. 71.

15. Answer of State of New Jersey to Order No. 71 to Show Cause.

[fol. 241] 16. Order No. 72 directing the Trustees to pay certain amounts on account of New Jersey State taxes for which the Debtor is directly or indirectly liable.

17. Part of Reply of Claimant, State of New Jersey, to Trustees' objections to tax claims, pages 1 to 5 complete; first four lines on page 6 and prayer and signature on page 12.

18. Petition of the Trustees of the Debtor for authority to compromise, pursuant to Chapter 290 of the Laws of New Jersey of 1941, certain taxes levied by the State of New Jersey for the years 1932 to 1940, inclusive, etc.

19. Order No. 123 authorizing the Trustees of the Debtor to compromise, pursuant to Chapter 290 of the Laws of 1941, certain taxes levied by the State of New Jersey for the years 1932 to 1940, inclusive, etc.

20. Petition of Trustees for Order No. 135 instructing them concerning payment to the State of New Jersey of taxes levied against the Debtor and certain of its affiliated companies for the year 1941.

21. Parts of Minutes of Hearing before Hon. Guy L. Fake, U. S. D. J., November 24, 1941, pages 2269 to 2276, inclusive.

22. Order No. 135 instructing the Trustees to pay to the State of New Jersey on or before December 1st certain taxes levied against the Debtor and certain of its affiliated companies for the year 1941.

23. Petition of the Trustees for instructions whether or not they should comply with Chapter 241 of the Pamphlet Laws of New Jersey of 1942 and for Order

No. 161 requiring the Attorney General, the Comptroller, and the Treasurer of the State of New Jersey, and all other parties, to show cause why the amount of the tax claim of the State of New Jersey against the Debtor for the years 1932 to 1939 should not be fixed at the principal amount of taxes alleged to be due, payable in the manner, at the time, with the interest, and upon the terms and conditions prescribed by Chapter 241, and why the interest or interest penalties as claimed by or on behalf of the State of New Jersey in these proceedings should not be disallowed.

24. Order No. 161 to Show Cause.

[fols. 242-243] 25. Order No. 163 adjudicating the amounts in which the claims of the State of New Jersey should be allowed and directing the Trustees to comply with Chapter 241 of the Laws of New Jersey of 1942.

26. Petition of Trustee for Order for instructions regarding the payment of taxes to the State of New Jersey.

27. Order No. 333 authorizing and directing Trustee to make payment on account of taxes claimed by State of New Jersey.

28. Part of Minutes of Hearing before Hon. Guy L. Fake, U. S. D. J., April 26, 1946, pages 4783 to 4788, inclusive, and first three lines of page 4789; portion of page 4819 beginning with "My last exhibit" and ending with "This is not cross."; last three lines on page 4827 and pages 4828 to 4846, inclusive.

29. Receipt of Homer C. Zink, Commissioner, Department of Taxation and Finance of State of New Jersey, dated May 6, 1946.

It is further stipulated and agreed by and between the above parties through their attorneys that this Stipulation shall form a part of the record in the above entitled appeal.

James D. Carpenter, Jr., Attorney for Debtor-Petitioner; Walter D. Van Riper, Attorney General; By Benj. C. Van Tine, Deputy Attorney General Attorney for The State of New Jersey, a Creditor.

Dated: July 27th, 1946.

[fol. 244] IN THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF NEW JERSEY

In the Matter of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, Debtor

In Proceedings for the Reorganization of a Railroad

Petition No. 1

No. —

PETITION

For an Order of Approval Under Section 205 Title 11, United States Code, and for Further Relief

To the Honorable the Judges of the District Court of the United States for the District of New Jersey:

The petition of The Central Railroad Company of New Jersey, a railroad corporation, hereinafter referred to as the Debtor, respectfully represents:

First: The Debtor is a railroad corporation organized and existing under the laws of the State of New Jersey; it is a common carrier by railroad engaged in the transportation of persons and property in interstate commerce, and is not a street, a suburban or interurban electric railway. During the six months' period immediately preceding the filing of this petition the Debtor has had, and now has, its principal operating office in Jersey City, New Jersey, in the District of New Jersey, and all of the railroad owned by the Debtor lies wholly within said State of New Jersey.

Second: Interest obligations of the Debtor have heretofore matured and remain unpaid, to and including October 1, 1939, in the amounts and on the dates following:

[fol. 245] Interest on Debtors' General Mortgage Bonds:

April 1, 1939, not paid when due	$343,530.00	
July 1, 1939, not paid when due	849,795.00	
October 1, 1939, not paid when due	343,542.50	
		$1,536,867.50

Debtor has paid on account of said taxes the following amounts:

1937	$2,161,737.57
1938	2,273,266.79

and has appealed to the State Board of Tax Appeals of the State of New Jersey to secure a review of the balance of said taxes. Said appeals are now pending and undetermined. On information and belief the taxes so assessed for said years are excessive and unlawful and said assessments were not made in accordance with the principles laid down by Judge Forman.

6. The statement of the taxes levied by the State of New Jersey against Debtor's property for the year 1939 [fols. 255-256] amounting to $3,415,922.05 was served on the Debtor on July 29th and under the provisions of New Jersey Revised Statutes 54:27-2 in so far as said taxes were valid, they became due and payable on any day up to and including December 1. Under date of August 3, 1939 the Debtor filed a complaint and appeal from said tax assessment to the State Board of Tax Appeals.

7. On information and belief the method by which the 1939 assessment was made was similar to the method used by the State in making the 1934, 1935 and 1936 assessments which Judge Forman held to be illegal.

8. In view of the above facts Debtor is advised that there is doubt whether any taxes are legally due by the Debtor for the year 1939, but if so Debtor is further advised that any such taxes constitute merely a claim provable in due course like other claims under Section 77 of the Bankruptcy Act.

Wherefore, Debtor prays that this Court enter an order instructing it whether it should prosecute its appeal before the State Board of Tax Appeals from the 1939 tax assessment and whether pending the filing and allowance of claims by creditors and a determination as to whether any valid tax levy exists against the Debtor for the year 1939 it should pay any part of the taxes so levied against it and if so what part.

The Central Railroad Company of New Jersey by Edward W. Scheer, President. Charles E. Miller, Attorney for Debtor.

[fol. 257] IN THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF NEW JERSEY

In Proceedings for the Reorganization of a Railroad

No. 29,778

In the Matter of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, Debtor

AFFIDAVIT IN SUPPORT OF PETITION FOR ORDER NO. 7

STATE OF NEW JERSEY,
County of Hudson, ss:

Frank M. Snyder, of full age, being duly sworn, upon his oath deposes and says:

1. That I am an officer, to-wit, the Comptroller of The Central Railroad Company of New Jersey, the Debtor herein, and as such have charge of its books and accounts, and have occupied that position since June, 1928.

2. The estimated liquid resources of the Company that will be available on December 31, 1939 are as follows:

Cash on hand December 9, 1939	$6,449,568	
During the remainder of December it is estimated that more will be received	3,244,416	
Making total cash available as of December 31, 1939		$9,693,984
[fol. 258] During the balance of December the estimated disbursements (excluding the sum of $570,000 for rent due the Lehigh Coal & Navigation Company) will be		3,327,322
Leaving on hand on December 31, 1939		$6,366,662
For purposes of operation of the railroad the normal working fund requirement is about		2,500,000
Leaving available for all other purposes		3,866,662
The present market value of all marketable securities held in the Company's Treasury on December 9, 1939 (not including $326,044 market value of securities in Insurance Reserve Fund)		3,230,796
Making the estimated liquid resources available on December 31, 1939		7,097,458

The Debtor is also obligated in respect of amounts remaining unpaid for property taxes assessed by the State of New Jersey for 1932 and subsequent years, as follows:

Year	Amount Assessed	Amount Paid	Balance Unpaid
1932	$4,148,774.18	$2,078,166.86	$2,070,607.32
1933	3,828,677.20	1,920,099.58	1,908,577.62
1934	3,899,987.75	2,343,578.97	1,556,408.78
1935	3,832,140.82	2,303,015.03	1,529,125.79
1936	3,741,897.06	2,099,544.79	1,642,352.27
1937	3,596,902.71	2,161,737.57	1,435,165.14
1938	3,782,111.73	2,273,266.79	1,508,844.94

On December 1, 1939 there will become due taxes assessed against Debtor by the State of New Jersey amounting to $3,415,922.05.

The Debtor has been contesting, in proceedings before the State Board of Tax Appeals and Courts of New Jersey and in the Federal Courts, its liability in respect of the amounts so assessed and remaining unpaid for said years. Appeals to the State Board of Tax Appeals of the State of New Jersey, the New Jersey Courts and the Federal Courts with respect to the taxes for the years 1932 and 1933 have resulted in the final denial of relief to the Debtor. In respect of the taxes so assessed for the years 1932 and 1933 Debtor is, therefore, subject to judgment for the unpaid taxes for said years amounting to $3,979,185 on which statutory penalties as of November 2, 1939 will amount to the [fol. 246] sum of $3,250,429, a total of $7,229,614 and to the sale of its property under such judgment. On October 20, 1939, the Attorney General of the State of New Jersey served notice on the Debtor that on November 2, 1939 pursuant to Section 54:28-1 and following sections of the New Jersey Revised Statutes, he would apply to the Honorable Thomas W. Trenchard, one of the Justices of the New Jersey Supreme Court, for an Order that the taxes for said years 1932 and 1933, together with the interest due thereon, and a reasonable sum to be certified by said Justice to be paid for the expense of the proceeding, be made a judgment of the New Jersey Supreme Court, and for a further Order that execution forthwith issue on said judgment directed to such Master of the Court of Chancery of New Jersey as shall be named by such Justice pursuant to the provisions

of Chapter 28 of Title 54 of the New Jersey Revised Statutes.

Decisions adverse to the Debtor in pending proceedings involving said unpaid balances of said assessments for 1934 and subsequent years may be handed down shortly; and such adverse decisions, upon becoming final, would immediately subject the Debtor to additional tax liabilities in the amounts of the unpaid balances for said years above stated, to-wit: $7,671,897, together with the statutory penalties thereon.

In addition to contesting the property taxes assessed by the State of New Jersey, as aforesaid, the Debtor has been contesting local assessments for some or all of said years, of which an aggregate of $4,065,953 has been paid and an aggregate of $2,339,173 remains unpaid, exclusive of statutory penalties. Efforts to persuade the Legislature of New Jersey to reduce Debtor's tax burden have to date been unsuccessful.

On October 18, 1939 the Debtor's cash on hand was $5,136,923 and unpaid drafts then in the hands of its Treasurer amounted to $314,142 leaving an available cash balance of $4,822,781. Debtor's cash receipts, October 19, [fol. 247] 1939 to October 31, 1939, both inclusive, are estimated at $2,070,982 and its cash requirements during said period (excluding amounts required to meet the obligations for interest, taxes and penalties above stated) are estimated at $2,033,970 resulting in estimated net cash receipts for this period of $37,012 and in an estimated cash balance on October 31, 1939 of $4,859,793. The minimum amount reasonably required as working capital for Debtor's current operations is $2,500,000. Thus, as of October 31, 1939, Debtor estimates it will have available cash in the sum of $2,359,793 with which to meet the aforementioned obligations for interest, past due taxes and penalties, and taxes becoming due December 1, 1939.

Debtor holds in its treasury, unencumbered, certain securities listed upon the New York Stock Exchange, or otherwise currently quoted, having an aggregate market value, at the close of business on October 18, 1939, of approximately $3,676,098 of which securities having a market value of $366,948 are held in Debtor's Insurance Reserve Fund. It also holds certain other securities of an aggregate par value of $8,730,557 not so listed or quoted

and having no presently ascertainable market value, and which have little or no value for purposes of sale or as collateral for loans. Certain of said securities are issued by component companies of Debtor's railroad system, or connections thereof, and could not be sold without impairing the integrity of said system, or its relations with such connections. Debtor is informed and believes and therefore alleges if it were forced to immediately dispose of its currently quoted securities it would obtain materially less in the aggregate than the total market value thereof as hereinabove set forth and that it will be impossible for it to secure any loan or loans of further funds upon its general credit or otherwise, save such amounts, if any, as might be borrowed solely upon the value, as pledged collateral, of the securities above mentioned; and that if any amount might be so borrowed, such amount, together with [fols. 248-249] Debtor's estimated cash resources, would be wholly insufficient to meet Debtor's financial requirements, so that the Debtor is without funds to continue to operate its system and property and maintain the same in condition and repair to render adequate service to the public and at the same time to meet its debts, including the aforesaid liabilities and obligations, as they mature, and the Debtor desires to effect a plan or reorganization pursuant to Section 205 of Title 11 of the United States Code relating to bankruptcy.

Third: A copy of this petition is this day being filed with the Interstate Commerce Commission.

Fourth: The filing of this petition by and on behalf of the Debtor was duly authorized by resolution of the Board of Directors of the Debtors adopted at a meeting thereof duly held on the 25th day of October, 1939.

Wherefore your petitioner prays that an order may be entered approving this petition as properly filed under said Section 205, and that it be granted all other and further relief to which it may be entitled.

The Central Railroad Company of New Jersey, by E. W. Scheer. Charles E. Miller, Attorney for Debtor.

I hereby certify that the foregoing is a True Copy of the original on file in my office. Benjamin F. Havens, Clerk, per Charles E. Jaeckel, Deputy. (Seal.)

[fol. 250] IN THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF NEW JERSEY

In the Matter of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, Debtor

In Proceedings for the Reorganization of a Railroad

Order No. 3

ORDER

This matter coming on to be heard in the presence of Charles E. Miller, Counsel for the Debtor, and David T. Wilentz, Attorney General of the State of New Jersey, appearing *pro se*, and the Court having considered Debtor's duly verified Petition No. 2, and having heard the arguments of counsel, and having considered the same,

It is, on this 1st day of November, 1939, Ordered Adjudged and Decreed that the said David T. Wilentz, as Attorney General of the State of New Jersey, his successors, representatives and employees be, and they hereby are enjoined and restrained from continuing the proceeding instituted by said David T. Wilentz, as Attorney General of the State of New Jersey, for the entry of judgment in the New Jersey Supreme Court for taxes levied against the Debtor by the State of New Jersey for each of the years 1932 and 1933 and for interest thereon and for an order [fol. 251] that execution forthwith issue on said judgment and from entering any judgment or judgments in said proceedings and from entering any order for execution thereon against the Debtor and from commencing or continuing any other judicial proceeding to enforce any lien for said taxes upon the estate of the Debtor until after final decree shall have been entered herein, or until further order of this Court.

Guy L. Fake, United States District Judge.

[fol. 252] IN THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF NEW JERSEY

In Proceedings for the Reorganization of a Railroad

No. 29,778

In the Matter of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, Debtor

PETITION FOR ORDER NO. 7

Instructing Debtor Whether it Should Pay Any Part of the Taxes Assessed Against Its Property by the State of New Jersey for the Year 1939 and If So What Part

To the Honorable the Judges of the District Court of the United States for the District of New Jersey:

The Petition of the Central Railroad Company of New Jersey, the Debtor herein, respectively represents:

1. This Court by its Order No. 1 prohibited Debtor from making any payment on account of taxes, assessments or other governmental charges, State or local, due or to become due and whether heretofore or hereafter assessed upon its property or any thereof in the State of New Jersey without further order of this Court.

2. The taxes assessed by the State of New Jersey against property of the Debtor for the year 1932 aggre- [fol. 253] gated $4,148,774.18 and for the year 1933 $3,828,677.20. Contending that the taxes so assessed were excessive and unlawful Debtor appealed to the State Board of Tax Appeals of the State of New Jersey and the New Jersey courts from said assessments but was unable to obtain relief. It thereupon instituted actions in this Court to restrain the collection of the part of said taxes which it contended was excessive. In connection with said actions Debtor paid $2,078,166.86 to the State on account of the 1932 assessment and $1,920,099.58 on account of the 1933 assessment. Thereafter this Court handed down decisions denying such injunctions and the decision of this Court was affirmed by the Circuit Court of Appeals for the Third Circuit. Application was then made to the Supreme Court of the United States for a Writ of Certiorari to review

the decision of the Circuit Court of Appeals, but this application, as was also an application for a re-hearing thereon, was denied. (*Central Railroad of New Jersey* v. *Thayer Martin*, 19 F. Supp. 63, 82, 100 F. (2d) 139, 306 U. S. 669.)

3. On information and belief the amounts so assessed against Debtor's property for the years 1932 and 1933 are excessive and unlawful and this Court, under Section 104 of Title 11 of the U. S. Code will have to determine the amount and legality thereof.

4. For the years 1934, 1935 and 1936, the State of New Jersey assessed taxes against Debtor's property as follows:

1934	$3,899,987.75
1935	3,832,140.82
1936	3,741,897.06

Thereafter, Debtor paid the following amounts on account of the taxes so assessed against its property:

[fol. 254]

1934	$2,343,578.97
1935	2,303,015.03
1936	2,099,544.79

An action was thereupon instituted in this Court to restrain the State from collecting the balance of the taxes so assessed for said years. By an opinion filed November 1, 1939 Judge Forman held that the amounts so assessed for said years 1934, 1935 and 1936 were excessive and that an injunction should issue to restrain the collection of any further taxes until such time as the taxing authorities of New Jersey re-value the property of Debtor in accordance with the principles laid down by Judge Forman in his opinion. No such re-assessment has as yet been made.

5. For the years 1937 and 1938 the taxes assessed by the State of New Jersey on Debtor's property were as follows:

1937	$3,596,902.71
1938	3,782,111.73

3. The tax claims of the State of New Jersey and its municipalities are as follows:

The amount of State Taxes claimed by New Jersey for the years 1932 and 1933 (not including penalties or interest)	$3,979,184	
The amount of State taxes claimed by New Jersey for the years 1934 to 1938, inclusive (not including penalties or interest)	7,671,896	
The amount of State taxes claimed by New Jersey for 1939	3,415,922	
Total tax claims of the State of New Jersey		$15,067,002
The amount of claims of New Jersey Municipalities for local taxes for the years 1932 to 1939 incl. total	2,612,207	
Total taxes claimed by the State of New Jersey and its Municipalities (not including penalties or interest)		$17,679,209

[fol. 259] It will therefore be seen that the tax claims asserted by the State and Municipalities in New Jersey, not including any penalties or interest, amount to approximately two and one-half times all of the cash that will be on hand on December 31st, plus the market value of all marketable securities in the Company's treasury. (Except $326,044 market value of securities in Insurance Reserve Fund.)

Frank M. Snyder, Comptroller, The Central Railroad Company of New Jersey.

Sworn to and subscribed before me this 12th day of December, 1939. Roy Bolles, Notary Public of New Jersey. My Commission expires March 28, 1943. (Seal.)

[fol. 260] IN THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF NEW JERSEY

In Proceedings for the Reorganization of a Railroad

No. 29,778

In the Matter of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, Debtor

Order No. 7

To Show Cause Why an Order Should Not be Entered Instructing Debtor Whether it Should Pay Any Part of the Taxes Assessed Against it by the State of New Jersey for the Year 1939 and If So What Part

Upon consideration of the Petition filed by the Debtor herein praying that an Order be entered instructing it as to whether it should pay any part of the taxes assessed against it by the State of New Jersey for the year 1939 and if so what part;

It is on this 7th day of December, 1939, Ordered, that David T. Wilentz, Attorney General for the State of New Jersey, William I. Woodcock, Jr., Counsel for the Reading Company, Fred N. Oliver, Counsel for certain Institutional Bondholders, Milton G. Shoenholz, Messrs. Greenbaum, Wolff & Ernst and William A. Roberts, Counsel for certain bondholders, Colie & Schenck and Larkin, Rathbone & Perry, Esqs., Counsel for Central Hanover Bank and Trust Company, Messrs. Martin & Reilly, Samuel [fol. 261] D. Matlack and Messrs. Milbank, Tweed, Hope & Webb, Counsel for the Lehigh Coal and Navigation Company and Messrs. McCarter & English, counsel for certain bondholders, show cause before this Court at the United States Court House at Newark, N. J., at 10:30 A. M. on December 13th, 1939, why an order should not be entered herein instructing the Debtor whether it should pay any part of the taxes assessed against it by the State of New Jersey for the year 1939 and if so what part.

Proper cause being shown therefor, service of a copy of this Order and of the aforesaid Petition, certified by counsel for the Debtor, shall be made by depositing a copy of said petition and order, enclosed in a duly stamped

envelope addressed to each of the persons hereinabove named, in the United States Mail on or before December 8th, 1939.

Guy L. Fake, United States District Judge.

[fol. 262] UNITED STATES DISTRICT COURT, DISTRICT OF NEW JERSEY

In Proceedings for the Reorganization of a Railroad

No. 29,778

In the Matter of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, Debtor

MINUTES OF HEARING

On order No. 7 to show cause why an order should not be entered instructing Debtor whether it should pay any part of the taxes assessed against it by the State of New Jersey for the year 1939 and if so what part.

Newark, N. J., Wednesday, December 13, 1939.

Before Hon. Guy L. Fake, U. S. D. J.

APPEARANCES:

Charles E. Miller, Esq., Alexander H. Elder, Esq., and Donald R. Creighton, Esq., for Debtor.

John J. Solan, Esq., Assistant to the Attorney General, for the State of New Jersey.

Major Fred N. Oliver, for certain institutional bondholders.

Messrs. Greenbaum, Wolff & Ernst, by Justin N. Reinhardt, Esq., and Messrs. Roberts & McInnis, by Edgar Turlington, Esq., for a bondholders' protective committee. [fol. 263] Messrs. Colie & Schenck, by Alexander T. Schenck, Esq., and Messrs. Larkin, Rathbone & Perry, by Hovey C. Clark, Esq., for the Central Hanover Bank & Trust Company, Trustee.

Messrs. Martin & Reiley, by Blair Reiley, Esq., and Messrs. Milbank, Tweed, Hope & Webb, by William M. Evarts, Esq., for The Lehigh Coal and Navigation Company.

The Clerk: In the matter of the Central Railroad of New Jersey, on an order to show cause why an order should not be entered instructing Debtor whether it should pay any part of the taxes assessed against it by the State of New Jersey for the year 1939 and if so what part.

Mr. Miller: If your Honor pleases, I have two gentlemen I would like to introduce to the Court: Mr. Alexander H. Elder, of the Massachusetts and the District of Columbia Bar, and Mr. Edgar Turlington, of the Bar of the District of Columbia.

The Court: Very glad to meet you, gentlemen; and you may upon this introduction speak in the cause.

Mr. Miller: If your Honor pleases, the matter comes on this morning pursuant to a petition filed in the cause and a rule to show cause.

Now, as the Clerk said, the petition is for instructions to the Debtor whether it should pay any part of the taxes assessed against its property by the State of New Jersey for the year 1939, and if so, what part. The petition in brief——

The Court: Who is making the application?

Mr. Miller: The Debtor made the application.

The Court: I beg pardon?

Mr. Miller: The Debtor made the application.

The Court: The Debtor is making the application to the Court.

Mr. Miller: For instructions.

[fol. 264] The Court: For instructions. And upon what is that based?

Mr. Miller: On this: During the period between the filing of the petition and the confirmation of the Trustees, the officers of the Debtor are to carry on the business pursuant to the orders of the Court. We are coming in because I understand the authorities of the State of New Jersey felt that the Debtor——

The Court: Have they made an application?

Mr. Miller: No, no formal application. The only application is the application of the Debtor, for instructions. And I point out at the beginning that this application for instructions only relates to the taxes assessed by the State of New Jersey for the year 1939. There is no other tax before the Court.

Now, the petition in brief points out that by your Order No. 1 you directed——

The Court: Let me have a copy of the petition, please.

Mr. Miller: This is a copy of the petition for Order No. 7 (handing document to the Court). I will have to go back and get my copy now. I have got one right here.

The petition points out that by your Order No. 1 you directed the payment of taxes other than taxes due the State of New Jersey——

The Court: I didn't get that.

Mr. Miller: The petition that is before you today points out, recites, that by your Order No. 1—that is, approving the petition—you directed that taxes should be paid other than taxes due the State of New Jersey. The petition sets out that for the years 1932 and 1933 the Debtor paid 60 percent of the taxes assessed against it by the State of New Jersey and litigated the balance; and it still contends that that balance is unlawful and excessive. And of course your Honor remembers that under Section 64 of the act as amended in 1938, if any question with regard to taxes arises it is the duty of this Court to pass upon the question.

[fol. 265] Now, the petition further sets out that with respect to the taxes for '34, '35, and '36, the Debtor again paid 60 percent of the taxes assessed by the State of New Jersey and instituted an action in this court which resulted in a decision handed down December 1 by Judge Forman, holding that the taxes assessed for those years by the State were on an unlawful basis, and enjoining or directing the enjoining of the unpaid balance until there is a reassessment in accordance with the directions of that decision.

The petition sets out that for the years 1937 and 1938 it has also paid 60 percent of the taxes assessed by the State and that appeals from the assessments made by the State are pending before the State Board of Tax Appeals of the State of New Jersey.

It sets out that some three million odd dollars were assessed for 1939, and also that there is a proceeding pending before the State Board of Tax Appeals with respect to the legality of that assessment; the petition asserting that the assessment for 1939 is again illegal and excessive, and an assessment made contrary to the provisions of the decision of Judge Forman.

Now, assuming that one of the most important things that your Honor will have to consider is the financial status of this Debtor, because after all your ultimate ob-

ligation in this proceeding is to work out a plan for a reorganization, I have had prepared and submit herewith an affidavit. I served it on some of my associates who are here, in accordance with the notice. If anybody else wants a copy they may have it. This affidavit sets forth the following:

"Frank M. Snyder, of full age, being duly sworn, upon his oath deposes and says:

"1. That I am an officer, to-wit, the Comptroller of The Central Railroad Company of New Jersey, the [fol. 266] Debtor herein, and as such have charge of its books and accounts, and have occupied that position since June, 1928.

"2. The estimated liquid resources of the Company that will be available on December 31, 1939 are as follows:

Cash on hand December 9, 1939		$6,449,568
During the remainder of December it is estimated that more will be received.	3,244,416	
Making total cash available as of December 31, 1939		$9,693,984
During the balance of December the estimated disbursements (excluding the sum of $570,000 for rent due the Lehigh Coal & Navigation Company) will be	3,327,322	
Leaving on hand December 31, 1939		$6,366,662"

The affidavit sets forth that for working funds two million and a half are required, leaving available for all other purposes $3,866,662.

The affidavit sets forth that in addition the market value of the marketable securities of the Debtor amount to $3,230,796, making the estimated liquid resources available for all purposes on December 31, 1939, $7,097,458.

Now, one of the things that we are confronted with out of that is taxes, which are set out here, for the years '32 and '33, '34 to '38, and '39; total tax claims of the State of New Jersey, $15,067,002, and $2,612,207 of munici-

palities; making total tax claims, State and municipal, $17,679,209.

In other words, the financial situation is this: We have seven million dollars of available liquid resources. That includes cash and securities. And against that we are confronted with possible tax claims of seventeen million dollars.

[fol. 267] Now, of course, the significance of that seems to me to be this: that no payment of any kind of any amount can be made that is going to cripple the operation of this property in the public interest.

Now, if we were operating the railroad ourselves, if we hadn't filed a petition, it is probable that we might have made, would have made, a payment on account of the taxes for the year 1939; but inasmuch as a petition has been filed and the property is now in the hands of this Court, I think there are some legal reasons that your Honor must consider as to whether you have the power to order any payment to be made.

Now, as I understand the fact, the inception of this particular proceeding arose from the fact that the Government of the State of New Jersey felt that a part at least of this tax should be paid. The distinguished assistant of the distinguished Attorney General is here, Mr. Solan, and I would like to yield to him for the purpose of having him advise your Honor of the reasons he thinks make it legal for your Honor to direct us to make any payment at this time.

Mr. Solan: If the Court please, I appear on behalf of the Attorney General in response to the rule, and we seek from your Honor an order that the Debtor pay out of the funds in hand, the assets, the estate of this Debtor, at least 60 percentum of the taxes levied against the property for the year 1939.

The facts with respect to our statute and with respect to the situation of the tax are briefly these: Our statute provides for the tax on this railroad property, the custody, operation and control of which is now under your Honor's order. The tax was assessed in 1939, actually fixed about the middle of the year, and is payable any time up till December 1, 1939, a month after this Court took the property over. The——

The Court: When does the tax become a lien under the State law?

[fol. 268] Mr. Solan: The tax became a lien——

Mr. Miller: Would it bother counsel if I answered the question of the Court?

Mr. Solan: Pardon?

Mr. Miller: Would it bother you if I answered his Honor's question?

Mr. Solan: No, no.

Mr. Miller: The 1st of June under the statute. I have a little memorandum of that.

The Court: Does it become a lien on that date?

Mr. Miller: Yes.

Mr. Solan: I agree.

The Court: I beg pardon?

Mr. Sloan: I agree, your Honor.

The Court: Does it become a lien on that date?

Mr. Miller: The statute says so. I have a little memorandum of that on a slip of paper.

The Court: What does the statute say? I was wondering whether or not it became a lien on that date or became a lien on December 1.

Mr. Miller: No, on June 1. There is a memorandum of the statute (handing memorandum to the Court).

The Court: Well, when does it commence to draw interest?

Mr. Miller: December 1. It becomes due and becomes a lien on June 1, draws interest on December 1. But under Anderson case in 203 United States it was held that a New Jersey tax, due on June 1, drawing interest from December 1, becomes due on June 1.

Mr. Solan: Your Honor, I have here an excerpt from the statute:

"These taxes shall be a lien paramount to all other liens upon the land and tangible property and franchises of the company in this State. The lien shall take effect on June 1 of the year in which the tax is payable.

[fol. 269] And the tax is payable any time between—we always think of it as payable on December 1 because it is on that day and not until that day that it begins to bear interest if not paid.

There is another section of the statute which permits the Attorney General ten days after it is due—that would be December 10, it not being paid—to apply for a summary judgment and execution to realize on the judgment for the amount of the tax unpaid. That proceeding, of

course, has not been permitted as a result of this proceeding.

The taxes for the calendar year, two months of which, of course, this Debtor will be in custody of the property—he is in custody of the property on the day on which the tax begins to bear interest and——

The Court: Who is in custody?

Mr. Solan: The Debtor is in the custody——

The Court: Yes.

Mr. Solan: Of this Court. The Debtor is in custody under the order of this Court.

The tax is not apportionable. It is fixed in the entire amount, a fixed sum. It can't be apportioned. And it bears interest from December 1, and is subject to summary judgment and execution to realize on it December 10. Of course, if no order is made, this tax will bear interest from that time, from December 1. That is the situation.

This, of course, is a property tax, not a franchise tax, like the Anderson tax. The Debtor under the situation here is, of course, in the custody of the property when the tax becomes payable. It is payable every day during the time that he is in the custody, during this year. We, of course, claim that the Anderson case is not appropriate. We claim under another section of the Federal statute this tax may rightly be ordered paid, other than the Bankruptcy Act.

[fol. 270] Now, the situation is that this litigation concerning these taxes has been in effect since the beginning of 1932. The controversy has been with respect to the valuation, nothing else; the valuation. In other words, the company each year has claimed that the valuation was too high, and therefore they have protested only against a part of the tax, not the tax as a whole; and that part of the tax, I think, will be conceded to be 40 percent. Because the facts are that the company has voluntarily paid and thereby conceded 60 percent of the levy each year from 1932 during all this litigation; and therefore we have a controversy respecting only 40 percent of this tax. And we are not asking the Court now to make any order respecting that part of the tax. We are asking the Court to make an order respecting that part of the tax which has not been in litigation; and as——

The Court: Well, is it divisible?

Mr. Solan: Pardon?

The Court: Is it divisible? Hasn't the District Court at Trenton, Judge Forman, ruled that the entire levy is invalid and that there must be a reassessment upon the principles laid down in that opinion?

Mr. Solan: I don't so understand, your Honor. The facts are in that case that Judge Forman has not yet made his findings of fact or his determinations of law, and has not yet made his decree. He has, of course, in an opinion made certain assertions with respect to the matter, but we think that the matter will be controlled by his findings and by the decree. The effect of Judge Forman's opinion if applied literally would be that we would be restrained from collecting 40 percent of the tax. Because at the initiation of the cause——

The Court: Has he so held?

Mr. Solan: At the initiation of the cause, your Honor, he ordered 60 percent of the taxes paid. That has been paid. He does not attempt to make any effort to have that [fol. 271] repaid; and it is conceded by everybody to be due. It is not really in question. So the decree——

The Court: One of the questions in my mind at the moment is whether or not there is now a valid levy for the year 1939.

Mr. Solan: Your Honor, there isn't any question about that. There is a levy. I think the Court will take judicial notice of the fact that this property is in the State of New Jersey and was on the tax day, and that it was in the use of this company. There is no real question about that. I do not think the gentlemen here will dispute that fact. And they are, of course, in possession of it. And this property on which this tax was imposed was in railroad use. I have a copy here of the tax act, providing that all property in this State in railroad use should annually be taxed. So there is no real question, as I understand it, that this property is subject to tax and that a levy thereon has been made, but the issue is with respect to the amount of tax that may be exacted, and that arises out of the valuation placed on the property. And in that connection I have and should like to offer a short affidavit from the State Tax Commissioner, with the intent of showing that for the year 1939, as contrasted with the other years, from '36

on to '39, the valuation of the property has been reduced each year, and has been reduced to the lowest extent in 1939. In other words, as this affidavit shows, in 1938 the property was valued for taxation at $81,877,379, and in 1939 it is seventy-two million—practically ten million less.

The point I wish to make and draw from that is that there should be really less complaint this year than there was in the preceding years due to the fact that we are exacting a smaller amount of taxes, due to the fact that we have lowered the valuation of the property.

And that is the situation. In all this litigation during this last eight years, the question involved has been the [fol. 272] legality of substantially that 40 per cent. And that is the reason why we feel justified in coming here and asking that your Honor do what without a doubt the company would have done had it not had resort to this proceeding, and that is on December 1 make a part payment of this tax.

I can't impress on your Honor how necessary it is that this be paid, how necessary to the municipalities and to the State, for the reason that there has been, as the record shows, as this petition shows, a substantial withholding of what is deemed to be the true tax for eight years. So that it is absolutely necessary to carry on that these municipalities get at least a portion of the tax, and in equity they are certainly entitled to that portion not in dispute.

Now, dealing with the question of the——

The Court: Upon what theory does this Court have the power, upon the filing of the petition and before the confirmation of Trustees?

Mr. Solan: Your Honor, that is a point that I would like to discuss now. I believe that you have the power. I believe that upon the invoking of the jurisdiction of this Court under Section 77, this property came under the control of this Court, and the only difference that arises between this and the ordinary case is that in this case instead of qualified trustees being your agents in the carrying out of the duties imposed on you under the act, the corporation itself, the Debtor itself, occupies that position; and I think it is very clear that the statute contemplated that.

I am reading a portion of Section 77(a) and in part paragraph (2) of Section 77 (c). The first, the pertinent part, it seems to me, says:

"If the petition is so approved, the court in which such order is entered shall, during the pendency of the proceedings under this section and for the purposes thereof, [fol. 273] have exclusive jurisdiction of the debtor and its property wherever located, and shall have and may exercise in addition to the powers conferred by this section all the powers, not inconsistent with this section, which a Federal court would have had if it had appointed a receiver in equity of the property of the debtor for any purpose."

Section 77(c), which should be read in connection with that for this particular point, it seems to me, says:

"Prior to the appointment"——

The Court: Just a moment. Where?

Mr. Solan: Paragraph (2) of Section 77 (c).

The Court: Paragraph (2)?

Mr. Solan: Section 77 (c).

The Court: Yes. What part are you reading there?

Mr. Solan: "Prior to the appointment of a trustee"——

The Court: Yes.

Mr. Solan: "Prior to the appointment of a trustee, the debtor on behalf of the court shall continue in the possession of the property and shall operate the business thereof during such period, and shall have all the title to the property and shall exercise all power consistent with the provisions of this section, subject at all times to the control of the judge, and to such limitations, restrictions, terms and conditions as he may from time to time impose and prescribe."

We feel that a consideration of the history of this legislation bears out the contention that until the qualification and formal qualification of the trustees, it was the intention of the Congress that your Honor should operate this property through the Debtor.

The Court: Are you taking your basis from the historical note that I find here to the act?

Mr. Solan: I am not—I confess I haven't seen the note, your Honor.

The Court: All right. Proceed.

Mr. Solan: It is an attempt on my part to point out that the '33 act provided for the appointment of a temporary

[fol. 274] trustee or trustees pending the confirmation, and that this act eliminates that section, and this act does not indeed provide for the appointment of any temporary trustee.

I have examined some of the authorities on the subject and I have a statement written by Henry J. Friendly, which appeared in the Columbia Law Review, 36 Columbia Law Review, 27, in which he in part says:

"The most important of the administrative changes are those relating to the appointment of trustees. Under the original act such appointment was discretionary; under the amendment, it is mandatory. Under the original act trustees were required to be chosen from a panel 'selected and designated in advance' by the Commission;" —the I. C. C. "the amendment abolishes the panel and substitutes a requirement of 'ratification' by the Commission. The provisions of the original act for a temporary trustee or trustees are omitted; instead the debtor operates the property until the appointment of trustees, after a hearing on notice, and the ratification of such appointment by the Commission."

And in a footnote at page 40 of this article I find this statement, in which the author seems to indicate the reason for the change in the '35 act allowing the debtor to continue to operate the property until the confirmation. He says:

"This change was said to be necessary because under the present system, he (the judge) can put in a temporary trustee and get him going before he has the hearing and, of course, it is harder to oust a man when he is in, than to keep him from being appointed originally."

It is also, it seems to me, apparent that there had to be somebody to act for your Honor in the conduct of the business during this interval.

The Court: Well, of course, the Debtor is permitted to continue the operation of the business.

[fol. 275] Mr. Solan: Yes; and our understanding is——

The Court: Under the section of the statute that you read a moment before.

Mr. Solan: Yes; and our understanding is that he is to continue, and that the mere fact that there is a delay in the confirmation of the trustees is not to prevent your

Honor from carrying on any functions that he may ordinarily have. In other words, they are to take the place during the interval, the debtor——

The Court: The question then is whether or not these taxes may be considered as operating expenses. Isn't that it?

Mr. Solan: There may be some question about that raised. I don't think there is. I frankly don't think there is because——

The Court: Well, do you say the taxes are part of the operating expense, or are they not?

Mr. Solan: I say that they are really part of the operating expense. The point is this: Here is property which this company is using. Now, of course, it is the law of the land that anybody who uses property——

The Court: How does the railroad set up its books with relation to taxes? Does it set them up as part of the operating expense, in their accounting work?

Mr. Solan: I am sure, your Honor, I don't know.

The Court: Can any one state that to me? Can any one here give me any information on that?

Mr. Elder: Your Honor, if I may answer the question, the accounting is governed by the rules of the Interstate Commerce Commission, and taxes are not under operating expenses but under a separate account known as Railway Taxes Accruals. That's an entirely distinct item from operating expenses.

The Court: And the books are kept that way under the direction of the Interstate Commerce Commission, is that correct?

[fol. 276] Mr. Elder: That's correct, yes, sir.

Mr. Solan: Your Honor, we feel that under the Federal statutes the debtor is required to pay the taxes to the State. The statutes we rely on are the Section 64 (a) of the National Bankruptcy Act, which is the provision in the act, the old act, as you will recall, which requires trustees to pay taxes. The question has been bruited as to whether that is applicable to proceedings under 77.

The Court: Well, there is a reference to it here, isn't there?

Mr. Solan: I have succeeded in finding a couple of cases involving——

The Court: Well, isn't there a reference in 77 to the general Bankruptcy Act,——

Mr. Solan: I don't think so.

The Court: —which provides that where not otherwise to the contrary required, the Bankruptcy Act applies?

Mr. Miller: Yes, sir, there is.

The Court: Where is that? Let me have it.

Mr. Miller: I will find it for you and give it to you in a minute.

Mr. Solan: I find, your Honor, two cases, which I have cited here in a memorandum which I will be glad to hand up, involving proceedings under the Railroad Act, Section 77, in which the Court felt that Section 64 (a) was applicable and justified the Court in paying the taxes. Those are the cases involving the New York, Ontario & Western and one involving the Denver and Rio Grande and——

The Court: But the issue there, I suppose, arose after the trustee's confirmation.

Mr. Solan: I think I might say that most of these cases perhaps that I have cited arose after the trustees had qualified, but if my initial contention is correct it doesn't really make any difference, because I feel that this Debtor stands in and performs the same function today——

[fol. 277] The Court: As the receiver.

Mr. Solan: —as the trustee, when qualified.

The Court: As though he were a temporary receiver.

Mr. Solan: Yes. And the theory is, if your Honor will bear with me on that point, that it is very distinct, the idea of Congress, that this property should at all times be operated, there should be no let-up in it; and therefore we must concede that Congress when it made this provision had in mind that dealing with the Interstate Commerce Commission there might ensue a delay in the qualification and approval of trustees, and therefore it provided this way, and made no provisions for any temporary trustee nor temporary receiver; and if the purpose of the act is to be carried out, that is if business is to be carried on during this interval, it must be on the theory that the Court operates through the medium of the Debtor. And for that reason these cases, even though they do involve cases where the trustees were in court and were seeking to prevent payment, are nevertheless applicable.

In the Denver case the Court says:

"As already pointed out, Section 77 is bankruptcy; an integral part of the act, made so by its very provisions.

We fail to find anything inconsistent with the application we have made."

The Court went on to say:

"No court can countenance without compelling cause the nonpayment of taxes legally owing by debtors under its exclusive jurisdiction, especially where, as here, the debtor is the largest taxpayer in the state. Any delay is a serious matter to the states, counties and school districts, directly impairing their functions."

But aside from relying on that section of the act of Congress, 64 (a) of the Bankruptcy Act, we find we are able to rely on Section 124 (a) of the Judiciary Act, which is usually referred to as the 1934 act, and which reads:

"Any receiver, liquidator, referee, trustee, or other officers or agents appointed by any United States court [fol. 278] and as authorized by said court to conduct any business, shall from and after June 18, 1934, be subject to all State and local taxes applicable to such business the same as if such business were conducted by an individual or corporation: Provided, however, that nothing in this section contained shall be construed to prohibit or prejudice the collection of any such taxes which accrued prior to June 18, 1934, in the event that the United States court having final jurisdiction of the subject matter under existing law should adjudge and decide that the imposition of such taxes was a valid exercise of the taxing power by the State or States, or by the civil subdivisions of the State or States imposing the same."

And with respect to that we are very fortunate in being able to say to your Honor that the United States Supreme Court in a case decided within the last two weeks has upheld not a tax but a penalty on a tax under this Section 124 (a) of the Judiciary Code. The case is Boteler *v.* Ingels, and it was decided November 6, 1939. It involved a case where the laws of California required operators of motor vehicles to obtain a license and pay a fee, and this trustee of the bankrupt estate, being in possession on the day on which the license should be obtained, neglected to do it and resisted the payment of the penalty which was imposed, and the Court unanimously, the Supreme Court of the United States, upheld the claim of the State that the penalty itself should be imposed and could be collected.

The Court says:

"We need not determine whether without legislation such as the 1934 Act a trustee in bankruptcy conducting a business shall be subject to all State and local taxes."

And they go on and hold that that act is sufficient. That bankrupt was under 77B, which is not dissimilar in this respect; and the Court has there held that under that '34 section it becomes the duty of the trustees under 77B to pay State taxes.

Now,——

[fol. 279] The Court: And are they a prior lien to the lien of the bondholders?

Mr. Solan: This was a lien—in this particular case it was; the State had a lien on the vehicle, I believe.

Your Honor, on that point I would like to make clear that our statute provides that this claim for taxes shall be a paramount lien, and therefore in the ranking of it, in the classification of this, this claim necessarily comes high. So that it doesn't seem to me that there should be any great difficulty on that point. The exact language of our st*t*aute which is——

The Court: Well, I assume you have set that forth fully in your brief.

Mr. Solan: Yes, sir, I have set it forth.

Therefore I feel that any fair construction of this act justifies your Honor at this stage and grants your Honor at this stage power to make such an order as we apply for. I feel that the act of Congress really permits the trustee, or whoever stands in his shoes for the time being, to pay and puts him under a duty to pay these taxes.

Now, this tax is a tax on property, and I think that that ought to be very greatly borne in mind, because there are some cases which involve taxes on franchises or privileges which the trustee, of course, after the adjudication, the trustee or receiver, whoever he happens to be, may not use, and for that reason there is no claim, no just claim, that he should pay out of the property in his hands any tax for any period subsequent to the adjudication. That is, New Jersey *v.* Anderson dealt with our capital stock tax. But this is a property tax, and this property is now in control of the debtor. He is using it every day in the operation of his road. He couldn't operate his road without it. It is one of the obligations incident to taking it over. He can't take

the property over under any stretch of the imagination without meeting the obligations of the State. Surely, the Congress never meant, never in the world meant, by giving [fol. 280] these railroads the opportunity to reorganize under this Bankruptcy Act, that they should be relieved from their duties to pay property taxes. And those property taxes are now due, and if it were not for this Court we would be able to realize on them. Of course, in ordinary bankruptcy cases it is not unusual for the Court to direct the payment of rent while the receiver is operating the business and before the election of trustees.

The Court: Could this tax be considered upon the same basis as rent, do you suppose? Or does rent fall in a different classification under the Bankruptcy Act?

Mr. Solan: Your Honor, I believe it is under the same general obligation. It is the——

The Court: Now, under your tax levy you would have a right to take possession were it not for the injunction,——

Mr. Solan: Yes.

The Court: —which the filing of the petition here carries with it.

Mr. Solan: Yes, your Honor.

The Court: You would have a right to take possession of the road.

Mr. Solan: We would have a right to realize on our tax, to realize on the property on which we——

The Court: Well, that would require a public sale, before you could take possession of it.

Mr. Solan: Yes, the scheme is—the statute provides a very summary proceeding. We just go before a Justice of the Supreme Court with a certification of the Comptroller as to the amount due, and on that mere certification he gives us a summary judgment, and then he issues an execution to realize on that judgment. So that we have a quick, speedy remedy; and of course that's interfered with by this proceeding.

I have a leading case on this question of property taxes—it is in 194 U. S. But its principles are just as applicable. [fol. 281] It is a case which involved the validity of taxes imposed on property in the hands of a trustee in bankruptcy, and the Supreme Court there had occasion to comment on the intent of the Congress in the exercise of its

bankruptcy power with respect to public dues and taxes against property of the bankrupt, and it said in part:

"By Section 7 of that act the title to all of the property of the bankrupt not declared to be exempt is vested in the trustee. By the transfer to the trustee no mysterious or peculiar ownership or qualities are given to the property. It is dedicated, it is true, to the payment of the creditors of the bankrupt, but there is nothing in that to withdraw it from the necessity of protection by the state and municipality or which should exempt it from its obligations to either. If Congress has the power to declare otherwise, and wished to do so, the intention would be clearly expressed, not left to be collected or inferred from disputable considerations of convenience in administering the estate of the bankrupt."

I have another case here which I won't read. In Thompson *v.* Louisiana, I found a case which involved the right of the Missouri-Pacific Railroad, a corporation of Missouri, to do business or to continue to do business in Louisiana, under a tax against foreign corporations for doing business. That was a franchise tax. And there the Court held that under Section 124 (a) Title 28 of the United States Code Annotated, any receiver, liquidator and so on shall pay; that the receiver of the Missouri-Pacific was duty bound to pay the Louisiana tax.

Your Honor, I want to say as vigorously as I can that this is a very serious question from the viewpoint of the State and its agencies. As I have, I think, stated before, there has been a withholding of a substantial portion of what we consider to be a part of this tax for eight years.

The Court: Well, just how serious is it, if you know?

Mr. Solan: How serious?

[fol. 282] The Court: The withholding of this tax.

Mr. Solan: Your Honor, I can state it, if you will permit me. I have seen an affidavit of Mr. Greer, the Comptroller of Jersey City—if I may state the contents.

The Court: Yes.

Mr. Solan: He states that some years ago, and Jersey City is vitally interested in this particular tax—he states in his affidavit that some years ago the City of Jersey City found that in order to carry on its municipal activities it needed at least 80 percent of this levy from these railroads, and with legislative sanction it got power to use municipal credit to borrow the difference between the 60 percent which

the railroads were paying and the 80 percent which it required. And therefore it is very vital, because Jersey City is not only absorbing in carrying on its functions 60 percent which has been paid but it has been during these years since '35 borrowing 20 pc. ent of the levy. That's how serious it is. And Mr. Greer goes on to say that if——

The Court: Well, is that affidavit here?

Mr. Solan: No, your Honor. It was in another proceeding.

The Court: Well, why wouldn't it be material here?

Mr. Solan: I would be very glad to file it with your Honor.

The Court: Are there any other cities that are in the same position?

Mr. Solan: I can't speak with respect to whether or not the other cities along the Central line are borrowing in anticipation of this money, but I do know, of course, that they are being deprived of this 60 percent, and I am quite sure——

The Court: Isn't most of this levy under the State statute allocated to public school purposes?

Mr. Solan: I can't state the figures but what is known as the first-class tax, that's on the main stem, is allocated [fol. 283] to the General State fund to a small extent, then to certain State institutions, and then whatever is left to general local school purposes. The second, third, and fourth class taxes, the proceeds of those classes, go to the municipalities in which the railroad has its property.

The Court: That is what is called second class?

Mr. Solan: Second, third, and fourth, yes.

The Court: What are the third and fourth classes? I am not familiar with them.

Mr. Solan: The second class——

The Court: Well, the first class is the main stem.

Mr. Solan: It is the main stem, excepting structures.

Mr. Miller: A hundred feet.

Mr. Solan: A hundred feet, the main line; with the exception of not including structures.

The Court: Now, the structures are second class?

Mr. Miller: The second class is the remaining used property. The third class is personal property, and the fourth class is the remaining property, including the franchise.

The Court: All right. Proceed.

Mr. Solan: Your Honor, I have undertaken to make clear the necessity and the meritorious claim we have for this

relief. We do not feel that we are asking for anything that is unfair, because it is something that has during all this turmoil and all this litigation been voluntarily paid. And the company has the funds. It would have doubtless paid them had this litigation not ensued. We are convinced that your Honor has the power, and we feel that the power should be exercised under all the equities and in all fairness and justice. And the failure to exercise the power even for a short time would be a very serious matter, because we are not only obliged to receive this tax but we are obliged under the way in which public affairs are carried on to receive this tax when due. The provisions are made for its payment and [fols. 284-319] for its expenditure when it is payable; and therefore any delay of any kind whatsoever will without doubt cripple the municipalities.

[fol. 320] In the District Court of the United States for the District of New Jersey

In the Matter of The Central Railroad Company of New Jersey, Debtor

In Proceedings for the Reorganization of a Railroad

No. 29,778

Order No. 11 Directing Debtor to Pay $2,049,553.23 on Account of Taxes Assessed Against Its Property by the State of New Jersey for the Year 1939.

The Debtor having filed its petition praying for instructions whether it should pay any part of the taxes assessed against its property by the State of New Jersey for the year 1939, and if so what part, and the matter coming on to be heard in the presence of

Charles E. Miller, Esq., Alexander H. Elder, Esq., and Donald R. Creighton, Esq., for Debtor.

John J. Solan, Esq., Assistant to the Attorney General, for the State of New Jersey.

Major Fred N. Oliver, for certain institutional bondholders.

Messrs. Greenbaum, Wolff & Ernst, by Justin N. Reinhardt, Esq., and Messrs. Roberts & McInnis,

by Edgar Turlington, Esq., for a bondholders' protective committee.

[fol. 321] Messrs. Colie & Schenck, by Alexander T. Schenck, Esq., and Messrs. Larkin, Rathbone & Perry, by Hovey C. Clark, Esq., for the Central Hanover Bank & Trust Company, Trustee.

Messrs. Martin & Reiley, by Blair Reiley, Esq., and Messrs. Milbank, Tweed & Hope, by William M. Evarts, Esq., for The Lehigh Coal and Navigation Company,

and the Court having considered the matter and having this day filed its decision directing the payment of the sum of $2,049,553.23, on account of the taxes assessed against Debtor's property by the State of New Jersey for the year 1939,

It is, on this 26 day of December, 1939 Ordered that the Debtor pay to the State of New Jersey the sum of $2,049,553.23 on account of the taxes claimed to have been assessed against its property by the State of New Jersey for the year 1939,

And, it is further Ordered that if the State of New Jersey shall file claim for the taxes assessed by it against the property of the Debtor for the year 1939, and such claim as finally allowed shall be less than the sum herein directed to be paid, any such excess shall be credited against any taxes hereafter assessed against said property. In the event that no claim is filed or allowed for such taxes, then the entire amount herein directed to be paid shall be credited against any taxes hereafter assessed against the said property by the State of New Jersey.

Nothing herein contained shall be so construed as to be a decision of the issues which may be involved as to the validity of the assessment or as to the amount or legality of the taxes. No interest or penalties shall accrue on the amount herein directed to be paid for any period of time after payment thereof.

Guy L. Fake, United States District Court Judge.

[fol. 322] IN THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF NEW JERSEY

In the Matter of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, Debtor

In Proceedings for the Reorganization of a Railroad

No. 29778

PETITION FOR ORDER No. 53 AUTHORIZING THE TRUSTEES TO PAY MONTHLY INSTALLMENTS ON ACCOUNT OF TAXES ASSESSED AGAINST PROPERTY OF THE DEBTOR BY THE STATE OF NEW JERSEY FOR THE YEARS 1932 AND 1933

To the Honorable the Judges of the District Court of the United States for the District of New Jersey:

Shelton Pitney and Walter P. Gardner, Trustees of the property of the Debtor, respectfully represent:

1. This Court, by Order No. 1 entered in this cause, prohibited the Debtor from making any payment on account of taxes, assessments or other governmental charges, state or local, due or to become due, and whether theretofore or thereafter assessed upon the property of the Debtor or any thereof in the State of New Jersey without further order of this Court.

2. The taxes assessed by the State of New Jersey against property of the Debtor for the year 1932 aggregated [fol. 323] $4,148,774.18, of which the Debtor promptly paid $2,078,166.86, and for the year 1933 the taxes so assessed aggregated $3,828,677.20, of which the Debtor promptly paid $1,920,099.58. Believing that the taxes as assessed for each of said years were excessive and unlawful, the Debtor appealed from said assessments to the State Board of Tax Appeals of the State of New Jersey, and in the case of the 1933 taxes to the New Jersey Supreme Court, but the debtor was unable to obtain relief by said proceedings. Thereupon, the Debtor instituted actions in this Court to restrain the collection of the parts of said taxes which it contended were excessive. Thereafter, this Court, without hearing oral testimony, handed down decisions denying injunctive relief, and the decisions of this Court were affirmed by the Circuit Court of Appeals for the

Third Circuit. Application was then made to the Supreme Court of the United States for a writ of certiorari to review the decisions of the Circuit Court of Appeals, but said application was denied and an application for a rehearing was also denied. (*The Central Railroad Company of New Jersey* v. *J. H. Th[illegible]artin*, 19 Fed. Supp. 63, 82; 100 Fed. (2d) 139; 306 U. S. 669.)

3. While the above-mentioned litigation was pending, the Debtor instituted suits in this Court to restrain the State of New Jersey from collecting unpaid balances of the taxes similarly assessed for the years 1934, 1935 and 1936, and after an extended hearing Judge Forman filed an opinion on November 1, 1939, two days after the Debtor had filed its petition in this Court under Section 205, Title 11, U. S. Code, holding that the taxes assessed against the Debtor for the said years 1934, 1935 and 1936 were unlawful and excessive and that an injunction should issue to restrain the collection of further taxes for said years until such time as the taxing authorities of New Jersey should revalue the property of the Debtor in ac-[fol. 324] cordance with the principles laid down in said opinion. The collection of any taxes in excess of 70 percentum of the taxes assessed for said years was enjoined.

4. The Trustees are informed and believe that the method by which the 1932 and 1933 assessments were made against the Debtor's property was similar to the method used by the State in making the 1934, 1935 and 1936 assessments, which this Court held to be illegal and excessive. The Trustees are further informed and believe that the amount of taxes assessed against the Debtor's property for the years 1932 and 1933 are excessive and unlawful, and that this Court has jurisdiction to determine the amount and legality thereof in this proceeding. Pending a determination of the amount of taxes lawfully due and payable for the years 1932 and 1933, however, the Trustees are satisfied that some amount in addition to the payments already made by the Debtor, which aggregate approximately 50 percent of the taxes assessed and levied for the years 1932 and 1933, will ultimately be found to be lawfully due and payable.

5. The Trustees are also advised and believe that funds of the Debtor amounting to $100,000.00 per month during

the next six months are and will be available to make installment payments on account of said 1932 and 1933 taxes over and above amounts needed for administrative expenses, and that it will be consistent with the interests of the Debtor's estate that such installment payments be made, and that in making said payments the Trustees will not be exceeding 70 percent of the taxes assessed for the years 1932 and 1933.

[fol. 325]. Wherefore, the Trustees pray that they be granted authority to pay to the State of New Jersey on account of taxes due and remaining unpaid on the property of the Debtor for the years 1932 and 1933, six monthly installments of $100,000.00 each, beginning July 1, 1940.

Shelton Pitney, Walter P. Gardner, Trustees.

Dated, June 12, 1940.

(Verification dated June 12 omitted in printing.)

[fol. 326] UNITED STATES DISTRICT COURT, DISTRICT OF NEW JERSEY

In the Matter of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, Debtor

In Proceedings for the Reorganization of a Railroad

No. 29,778

MINUTES OF HEARING BEFORE HON. THOMAS GLYNN WALKER, AT THE POST OFFICE BUILDING, NEWARK, N. J., ON WEDNESDAY, JUNE 12, 1940

APPEARANCES:

Mr. Josiah Stryker, by Mr. Mitchell, Special Counsel for the Trustees.

Hon. Walter Gardner, Trustee.

Mr. Alexander H. Elder, for the Debtor.

Hon. David Wilentz, Attorney General of New Jersey for the State of New Jersey.

Mr. Elder: Your Honor, the facts which are material are stated in the petition that is now being filed, and briefly they are these: By Order Number 1 in this bankruptcy proceed-

ing the Central Railroad was enjoined from paying any taxes due to the State or the municipalities on property in New Jersey. Recently the Attorney General communicated with me inquiring if we were not prepared to pay something additional on the 1932 and 1933 taxes.

The history of those taxes is this: When the 1932 taxes were assessed the Railroad took an appeal to the Board of [fol. 327] Tax Appeals and the appeal was dismissed. The appeal was based on the allegation that the assessed values were very excessive and violated the Constitutional rights of the Railroad. After the Board of Tax Appeals dismissed the appeal, it then went into this court and while the matter was pending the 1933 taxes came along and the taxes for the two years were considered by Judge Forman without taking oral testimony. The issues for the two years were submitted on the record that had been made before the Board of Tax Appeals; and as a condition for the injunction and restraining order that he gave us at that time, the Debtor paid 50 per cent of the tax for those two years.

After Judge Forman had passed on the matter adversely we took an appeal to the Third Circuit which affirmed his decision and then we applied to the Supreme Court for a writ of certiorari which was denied, and later a petition for a rehearing was denied by the United States Supreme Court. While that litigation was pending over a period of years we have similarly contested the 1934, 1935 and 1936 taxes, and the history of that litigation is quite different because after the Federal Court had given us a temporary injunction it went into a trial of the issues involved, the question of what the true value of the Railroad property in New Jersey was for those three years; and after a trial that extended intermittently over about a year, Judge Forman, two years after the trial started and two days after we filed our petition in bankruptcy, handed down his decision in substance holding that the assessments for the years 1934, 1935 and 1936 were illegal, were in violation of our rights under the Due Process Clause of the Federal Constitution.

We have as to those years paid about 60 per cent of the taxes, and in the final decree which Judge Forman entered in those cases for 1934, 1935 and 1936 he made the decree conditioned on our paying up to 70 per cent of the taxes for those three years.

[fol. 328] In his opinion which was announced on November 1, 1939, two days after our bankruptcy started, he made this reference to the earlier decision affecting the years 1932 and 1933:

"Anticipatory to any query relative to the Court's failure to condemn the method of railroad taxation in New Jersey in the 1932 cases, it should be noted that it was there emphatically pointed out that in no event should that decision be construed as a justification or an approval of the methods of the taxing authorities. Furthermore since that time, the Board's failure to give weight to the earnings of the Railroad, and its continued persistence in basing its assessments upon the principles herein condemned, has extended beyond the field of casual disregard of duty and now manifests itself as a permanent abuse of rights which should no longer be countenanced."

Now, in the light of that history and the Attorney General's inquiry a few days ago as to what the Trustees were going to do about those taxes for 1932 and 1933, the Trustees have filed this petition and I read from it merely the statement of their present information, Paragraph 4.

"The Trustees are informed and believe that the method by which the 1932 and 1933 assessments were made against the Debtor's property was similar to the method used by the State in making the 1934, 1935 and 1936 assessments, which this Court held to be illegal and excessive. The Trustees are further informed and believe that the amount of taxes assessed against the Debtor's property for the years 1932 and 1933 are excessive and unlawful, and that this Court has jurisdiction to determine the amount and legality thereof in this proceeding. Pending a determination of the amount of taxes lawfully due and payable for the years 1932 and 1933, however, the Trustees are satis-
[fol. 329] fied that some amount in addition to the payments already made by the Debtor, which aggregate approximately 50 per cent of the taxes assessed and levied for the years 1932 and 1933, will ultimately be found to be lawfully due and payable."

Then in the following paragraph the Trustees state to your Honor that they feel that the cash available makes it possible for them, without prejudice to the estate and with-

out interfering with their ability to pay administration expenses, to make instalment payments of $100,000 per month beginning on July first and continuing during the next six months; and we would like to have the Court's permission to do that. And I think perhaps the Attorney General, in view of the conversation I had with him last week, will desire to supplement what I have said as to the importance of our making some token payment on this account currently.

Mr. Wilentz: If your Honor please, the taxes involved were determined to be due by the United States Supreme Court. The matters relating to the appeal and the various steps and processes in connection with the appeal in the other cases as well as these, and the effect of the appeal in the later cases have all been related by the gentleman who has just recited those facts.

We disagree, of course, that this Court will be able to interfere with the judgment decree of the United States Supreme Court in the 1932 and 1933 cases. However that is not a matter for controversy today. That we will eventually have to come to.

We think the whole amount found to be due in those cases, as sustained by the United States Supreme Court will have to be paid and that this Court is without authority to change that amount; but, as I say, for the time being that is not before your honor.

I agree substantially with everything else that counsel has stated, except that we would like to have them increase the amount if the Company can, if the Company is finan-
[fol. 330] cially situated so that they can, from $100,000 to a more substantial amount. I take it that the Railroad's point of view is that if they are required, under Judge Forman's decision, to pay 70 per cent of the amounts assessed, that they probably feel that 70 per cent of the 1932 and 1933 taxes would likely be sustained by this Court. We say that 100 per cent would have to be sustained; they say that only such amount as the Court will find to be fair would be sustained. Assuming, then, that they would only be required to pay 70 per cent as against 100, there would still be 20 per cent of $8,000,000, approximately $8,000,000, for 1932 and 1933, 50 per cent of which they paid. 20 per cent of $8,000,000 would be about $1,600,000 exclusive of interest, charges &c.

Now, they propose to help us with payments of $100,000 per month for six months which would be $600,000. These taxes are very sorely needed by the municipalities affected; they cover various portions of the State, mostly the municipalities in Hudson County; and of course I need not tell your Honor, and I suppose we need not tell any court or anybody that is alive to the predicament of all municipalities just what it means to have been deprived of these great sums, most of which have been appropriated and spent in anticipation of its collection. And it has severely handicapped these municipalities, and frankly, I cannot understand how they have been able to operate while being deprived of these moneys, which they had reason to believe were due and had every reason to believe would be paid. So that right now I think it is not so much a matter of my appealing to your Honor to increase the amount, which I am not appealing to you to do unless these men representing the Railroad Company feel they are able to pay a little more. I think $100,000 is not quite enough, Mr. Elder, unless you men say you are unable to pay any more, of course then I don't want to impose upon the management of this Company in such a way as to interfere with its conduct while it is in the Court's hands. [fol. 331] Mr. Elder: It is very difficult, your Honor, to appraise the possible cash requirements of the railroad during the next six months.

Mr. Wilentz: Could you pay us $200,000 and if you found you couldn't, we would come in before the Court say after the first few months; that still would be way under the 70 per cent. If the Trustees could—after all, this money has to go to the State—we need this money for educational requirements and requirements of a necessary nature.

Mr. Elder: The real difficulty is the uncertainty of the present situation. Two weeks ago we got a notice from the War Department that they were going to assign for hearing on the 20th the propriety of an order requiring us to raise the bridge across the Hackensack River; the estimated cost would be two million and a quarter. Now, these orders of the War Department which are matters so clearly within their jurisdiction, are imponderables. Aside from that we have two million dollars of local taxes under appeal and Jersey City is pressing us just as you are, they are on the local end—and—you represent the State.

Mr. Wilentz: Well, so far as the State is concerned, we have cooperated to the fullest extent with all the railroad companies. As a matter of fact, in these 1932 and 1933 cases, after the decision of the Supreme Court, as you know, we made an arrangement with all the railroad companies to pay as best they could, and they have nearly all of them paid the entire principal amount for 1932 and 1933 in monthly instalments; and I have continued it from time to time at their request and permitted them to pay pretty nearly as they indicated they could, relying absolutely on them in that respect. And I rely upon the Trustees in this case too to the same extent, and if they say that $100,000 is all they can pay, I am going to be satisfied with it. But [fol. 332] I say again to them that I don't want them to be cheap with the State; that is to say, the State needs this money and the municipalities which are to get it need it, and even $200,000 would not be too helpful in view of the extent to which they need the help. But I would like to have the Trustees, if they feel reasonably sure that for the next few months they could increase it to $200,000, that they do so. Even the Lehigh Valley which is now in the hands of the Federal Courts, has been paying $100,000 a month and they paid a million dollars right off at the start.

Mr. Elder: Before coming I tried to get our statement of assets and liabilities for the month of April which I will file in the Court later in the week. I found it was not ready. It is possible, if we might have a recess of five minutes I might talk with Judge Gardner and see what his views are in view of the financial picture.

The Court: Of course you may.

Mr. Wilentz: As a matter of fact if you feel that another day back in the office would give you more information, we can wait and then Judge Gardner can come in and present——

Mr. Gardner: I think a day would be better. Mr. Pitney will be back tomorrow. I don't want to take it upon myself to decide so important a question. As Mr. Elder says, we are committed in so many ways for large payments, and of course we have to keep a working balance because the railroad has a big payroll. Fortunately we are not borrowing any money; that is a fortunate thing in this situation; all we have to do is keep afloat. In addition to this bridge matter, unless—as you may know, the President has vetoed this bill that would put such an expense on the Government

at large, which was passed by both Houses—unless it is passed over again we will have to pay that expense which would be a matter of fifteen months, running into a couple of million dollars—we have the L. C. & N. rental to con-
[fol. 333] sider—we don't know whether we want to keep it or whether we will disaffirm the lease—and we are committed in so many ways to large expenditures, we want to go along and do our share as you want us to, but we don't want to get tied up and come back and say we cannot do that. We want to make a satisfactory agreement and put it through.

Mr. Wilentz: Well, Judge, the amount I am suggesting I think is a reasonable amount. I have tried to do that not only with this railroad company, but all the railroads that have been tied up and I say if you cannot, we are not going to object at this time; we are going to try to go along, but I do hope you will find it possible to increase the amount, and if you find that you can, then you can present the order. It won't be necessary for us to be here.

Mr. Elder: We can agree on the form of the order and then advise the Court tomorrow as to whether the Trustees feel that they can recommend a larger amount.

The Court: Yes.

[fol. 334] IN THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF NEW JERSEY

In the Matter of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, Debtor

In Proceedings for the Reorganization of a Railroad

No. 29,778

Order No. 53 Authorizing the Trustees to Pay Monthly Installments on Account of Taxes Assessed Against Property of the Debtor by the State of New Jersey for the Years 1932 and 1933

Shelton Pitney and Walter P. Gardner, Trustees of the property of the Debtor herein, having filed their Petition praying that an Order be entered authorizing them to pay six monthly installments on account of taxes assessed against property of the Debtor by the State of New Jer-

sey for the years 1932 and 1933, and the matter coming on to be heard, and the Court having considered the same, It is, on this 13 day of June, 1940, ordered that the Trustees be and they hereby are authorized to pay to the State of New Jersey six monthly installments of $150,000. each beginning July 1, 1940, on account of taxes lawfully due on the property of the Debtor for the years 1932 and 1933.

(S.) Thomas Glynn Walker, United States District Judge.

[fol. 335] IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEW JERSEY

In the Matter of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, Debtor

In Proceedings for the Reorganization of a Railroad

No. 29,778

Petition for Order No. 66 Fixing the Time Within Which and Prescribing the Manner by Which Claims of Creditors Shall Be Filed

To the Honorable the Judges of the District Court of the United States for the District of New Jersey:

The petition of Shelton Pitney and Walter P. Gardner, Trustees of the Debtor in the above entitled cause, respectfully shows:

1. That Section 77 (c) (7) of the Bankruptcy Act provides that the judge of the court in which proceedings for the reorganization of a railroad are pending shall promptly determine and fix a reasonable time within which the claims of creditors may be filed or evidenced and after which no claim not so filed or evidenced may participate, except on order for cause shown, and the manner in which such claims may be filed or evidenced and allowed. No order has been entered in these proceedings which determines [fol. 336] and fixes such time for the filing or evidencing of claims of creditors of the Debtor herein.

Wherefore, your petitioners pray that an order may be entered herein determining and fixing the time within

which the claims of creditors may be filed and evidenced and the manner in which such claims may be filed and evidenced and allowed, and prescribing the notice thereof which shall be given to creditors.

Shelton Pitney, Walter P. Gardner, Trustees of The Central Railroad Company of New Jersey, Debtor.

Filed: Oct. 7, 1940.

(Verification dated Oct. 1st, 1940 omitted in printing.)

[fol. 337] IN THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF NEW JERSEY

In the Matter of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, Debtor

In Proceedings for the Reorganization of a Railroad

No. 29778

Order No. 66 Fixing the Time Within Which and Prescribing the Manner by Which Claims of Creditors Shall Be Filed

Shelton Pitney and Walter P. Gardner, the Trustees of the property of the Debtor, having applied on notice duly served on all parties in interest for an order in accordance with Subdivision (c) Paragraph (7) of Section 77 of Chapter 8 of the Acts of Congress relating to bankruptcy (11 U. S. C. A. 205 (c) (7)), determining and fixing a reasonable time within which the claims of creditors may be filed and evidenced and after which no claim not so filed and evidenced may participate except on order for cause shown, and the manner in which such claims may be filed and evidenced and allowed, and the matter having come on to be heard and the court having considered the petition of the Trustees, verified on October 1st 1940, and all the proceedings at such hearing, it is on this 7th day of October, 1940, ordered:

[fol. 338] 1. That the 31st day of December 1940 be and it hereby is fixed as the reasonable time within which the claims of creditors of The Central Railroad Company of

New Jersey, Debtor, including all claims of whatever character against said The Central Railroad Company of New Jersey, or its property, and including claims in tort which accrued prior to October 30, 1939, may be filed and evidenced, and after said date no claim not so filed and evidenced may participate, except on order of this court for cause shown; provided, however, that any claims arising out of the rejection by the Trustees subsequent to October 31, 1940 of any executory contracts or leases may be filed within 60 days after the date of mailing of notice of such rejection; and provided further that the entering into a liquidation agreement between a creditor and the Trustees shall be equivalent to the filing of a claim for the amount agreed upon in such liquidation agreement.

* * * * * * *

3. That each claim shall consist of a statement under oath in writing signed by the claimant, which shall set forth the name and address of the claimant; the nature of the claim, including dates and such other details as shall definitely advise the Trustees of the particulars thereof and distinguish the claim from other claims of a like nature; the consideration therefor; whether any, and if so, what security is held therefor; what payments have [fols. 339-341] been made thereon; any offsets or counterclaims due to the Debtor or the Trustees; full details of any suit pending on such claims and whether judgment has been recovered thereon; any liens, priorities or preferential classifications claimed; that the claim is justly owing from the Debtor to the claimant; and if said claim is founded upon a written instrument, a true copy thereof shall be annexed to the claim.

* * * * * * *

[fol. 342] 8. That when such publication and mailing shall have been completed, the Trustees shall file with the Clerk of this Court, their report with respect thereto.

Guy L. Fake, United States District Judge.

Filed: Oct. 7, 1940.

[fol. 343] IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEW JERSEY

In the Matter of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, Debtor

In Proceedings for the Reorganization of a Railroad

No. 29778

Order No. 93 Allowing Certain Claims and Referring to Special Master Certain Disputed Claims and the Objections Thereto, and Referring the Question of Priority of Claims

The Trustees of the Debtor having filed herein their report and recommendations concerning claims filed and claims liquidated by them pursuant to the provisions of Order No. 66 and having applied for an order of reference to the Special Master to hear and report upon all claims to which objections have been made and which have not been liquidated, subject to the right of the Trustees to enter into additional liquidation agreements, and to hear and report upon all questions of order and priority of claims heretofore or hereafter recommended for allowance; and the matter having been duly noticed for hearing on this day and being opened to the court by Shelton Pitney, one of and on behalf of the Trustees; and it being made to appear that since the filing by the Trustees of [fols. 344-347] their aforesaid report and petition, three certain claims, listed immediately below, have been withdrawn by the claimants and require no further consideration or action by this court, viz.:

Claim No.	*Name*	*Amount*
9	William Pazuk, Jr., by next friend, etc., and William Pazuk, Sr., individually	$25,000.00
15	Stephen Pekarovich	50,000.00
25	Dorothy Mellick	25,000.00

And this court having considered the report, recommendations and petition of the Trustees and good cause appearing herefor and no objection being made hereto:

It is, on this 1st day of April, 1941, on motion of the Trustees, Ordered:

* * * * * * *

[fol. 348] 8. That all disputed claims, except withdrawn Claims Nos. 9, 15 and 25, be and the same are hereby referred to Augustus C. Studer, Jr., Esquire, as Special Master, together with all objections thereto, for hearing and report thereon; provided, however, that the authority of the Trustees in their discretion to enter into liquidation agreements with respect to any of the disputed claims listed in Schedules 4 and 5 of Exhibit "A" annexed to the Trustees' report be and the same is hereby extended to July 1, 1941.

9. That it be and it is hereby also referred to said Special Master to hear, determine and report to this court upon the order and priority of all claims filed (except claims heretofore or hereafter withdrawn, and except Claim No. 24 and Claim No. 114, referred to in paragraphs 1 and 2 hereof, but including all claims heretofore or hereafter liquidated by the Trustees and all claims hereby allowed or hereafter recommended by the Special Master for allowance).

10. That said Special Master be and he is hereby directed upon all contested matters to take the testimony and hear argument, make findings of fact, adopt conclusions of law and submit the same to the Court as his report, either with or without opinion, as said Special Master may consider necessary, calling to his aid, if he deems it advisable, a stenographer, to the end that the testimony may be taken and transcribed and filed; that said Special Master shall regulate the proceedings and all hearings before him, shall have full authority to examine the parties upon, or in regard to, any matter arising before him in pursuance to this order of reference, and, also, to secure by subpoena and subpoena duces tecum, the appearance of witnesses and the production of documents; to examine on oath all witnesses produced by the parties [fol. 349] before him or to require the taking of testimony by deposition in accordance with the Acts of Congress and the General Orders in Bankruptcy; and to direct the mode in which the matters requiring evidence shall be proved

before him; and the form and contents of the report, with opportunity for objections thereto, shall be as provided by the rules of this Court.

11. That the allowance of the principal amount of the Debtor's General Mortgage Bonds, the question of the amounts of the unpresented and unpaid coupons appurtenant or formerly appurtenant thereto of coupon maturities on or prior to January 1, 1939, and the question of the amounts of uncollected and unpaid interest on registered bonds payable on interest dates on or prior to January 1, 1939, abide the filing of the Special Master's report pursuant to Order No. 88; and the said Special Master may, in his discretion, combine the two reports as one report or may make several reports, all as may be expedient or as occasion may require.

12. That this Court hereby reserves the right to revise, alter or amend this order.

Guy L. Fake, United States District Judge.

Filed: April 1, 1941.

[fol. 350] In the District Court of the United States for the District of New Jersey

In the Matter of The Central Railroad Company of New Jersey, Debtor

In Proceedings for the Reorganization of a Railroad

No. 29778

Petition of Trustees for Instructions Concerning Payment of Certain Taxes Levied by the State of New Jersey, and for Show Cause Order Thereon No. 71

To the Honorables the Judges of the United States District Court for the District of New Jersey:

The Petition of Shelton Pitney and Walter P. Gardner, Trustees, respectfully shows:

1. The State of New Jersey has levied certain taxes which became due and payble to the State Treasury on any day between June 1 and December 1, 1940 against the property of the Debtor or for which the Debtor is or may

be directly or indirectly liable, in whole or in part, against certain other properties, as follows:

[fol. 351]

Property of	Amount of Taxes Levied
The Debtor	$3,303,213.18
The Dover & Rockaway Railroad Company	3,872.93
The Ogden Mine Railroad Company	1,388.86
The New York & Long Branch Railroad Company	74,977.38*
Port Reading Railroad Company	8,267.14**
The Bay Shore Connecting Railroad Company	1,118.94*

(* Being the 50% of the entire amount of taxes assessed which the Debtor is under contract to pay.)

(** Being the 33⅓% of the entire amount of taxes which the Debtor is under contract to pay.)

2. The assessments upon which the above mentioned taxes were computed are deemed by your petitioners to be excessive and unlawful and appeals therefrom to the State Board of Tax Appeals of New Jersey have been taken and filed and are now pending.

3. Your petitioners are advised that such parts of said taxes as are not paid pending the outcome of said appeals and as are ultimately found to be due may be subject to interest penalties from December 1, 1940 under Section 54:27-4 of the Revised Statutes of the State of New Jersey.

4. For a statement of the Debtor's obligations in respect of the payment of the taxes so assessed against The Dover & Rockaway Railroad Company, The Ogden Mine Railroad Company, The New York & Long Branch Railroad Company, Port Reading Railroad Company and The Bay Shore Connecting Railroad Company, your petitioners respectfully refer to the allegations set forth in their petition verified on January 15, 1940 entitled "Petition for Order No. 20 of Trustees for Authority with [fol. 352] Respect to Payment of Certain State and Local Taxes Payable in New Jersey".

5. Pursuant to the authority granted to your petitioners by Order No. 58 in this cause your petitioners have acquired all of the 234 shares of stock of The Ogden Mine Railroad Company not theretofore owned or controlled by

the Debtor, and your petitioners are now preparing to dissolve said Company and to dispose of all of its assets in the interests of the Debtor's estate.

6. Your petitioners believe that it will be in the interest of the Debtor's estate that 60%, or some other substantial proportion, of the above mentioned taxes should now be paid in order to avoid the incurring of interest thereon from December 1, 1940 in the event that the pending appeals ultimately fail to reduce the taxes payable, or some of them, to such proportion or a lesser proportion of the entire sums so levied.

Wherefore your petitioners respectfully pray that they may have the aid and instructions of the Court in the premises and that they may be authorized and directed to make payments on account of the taxes referred to in this petition to the extent of 60% of each of said taxes, or to the extent of such other proportion thereof as this honorable Court may fix and determine.

Shelton Pitney, Walter P. Gardner.

Filed: November 25, 1940.

(Verification dated November 25, 1940 omitted in printing.)

[fol. 353] District Court of the United States, District of New Jersey

In the Matter of The Central Railroad Company of New Jersey, Debtor

In Proceedings for the Reorganization of a Railroad

No. 29778

Order No. 71 to Show Cause

Answer of State of New Jersey

Answer and Allegations of the State of New Jersey by David T. Wilentz, Attorney General, to Debtor's Petition herein.

The State of New Jersey, by David T. Wilentz, Attorney General, for its answer to Debtor's Petition herein, says:

1. Paragraphs 1, 2, 3 and 4 of the Petition are admitted.

2. Respondent has no knowledge, information or belief respecting the allegation in Paragraph 5 of the Petition.

3. Further answering said petition, respondent avers as follows:

That the sum of $66,691,090, fixed as the aggregate assessed valuation of the property in railroad use of The [fol. 354] Central Railroad Company of New Jersey for taxation for 1940 is the true value of said property, and that the sum of $3,303,213.18, fixed by the State as the tax against said property of said company for 1940 is a true and proper tax and is legally due and owing to said State. That the sum of $3,104,227, fixed as the aggregate assessed valuation of the property in railroad use of The New York & Long Branch Railroad Company for taxation for 1940 is the true value of said property, and that the sum of $149,954.75, fixed by the State as the tax against said property of said company for 1940 is a true and proper tax and is legally due and owing to said State. This respondent further alleges that the appeal from said tax of 1940 taken by said Central Railroad Company of New Jersey to the State Board of Tax Appeals of New Jersey, as referred to in Paragraph 2 of the Petition herein, is based on similar objections to the valuation of the property of this company and to the tax against said property as were interposed by way of appeal by said company to the valuation and taxation of its property for the year 1933 and that, notwithstanding the assertion of said objections, the valuations of the property of the company and the taxes levied thereon for the year 1933 was sustained by the State Board of Tax Appeals of New Jersey and, on review on writ of certiorari by the New Jersey Supreme Court. The case in which said issue was presented to said court is entitled Central Railroad Company, et al., v. Thayer Martin, reported in Volume 114, New Jersey Law Report, at pages 69, &c. Respondent alleges that in said case the same facts and matters were put in issue and were adjudicated upon as are now set up as grounds for relief in said appeals filed by said company with said State Board of Tax Appeals, as stated in Paragraph 2 of this petition. Respondent further avers that said Supreme Court of New Jersey was and is a [fol. 355] court of competent jurisdiction to hear and determine all said rights, facts and matters, and all questions

of law and fact pertaining thereto, and therefore avers that the said judgment of the New Jersey Supreme Court in the said 1933 case is res judicata with respect to the present appeal referred to in Paragraph 2 of the Petition herein.

Wherefore, the premises considered the State of New Jersey prays

1. That the Trustees of the Debtor be directed to pay immediately to the Treasurer of the State of New Jersey by and for the State of New Jersey the full amount of the taxes levied for 1940 against the Debtor and against the other companies named in Paragraph 1 of the Petition herein.

2. For such other and further relief as to the Court may seem just and equitable.

State of New Jersey, By David T. Wilentz, Attorney General of New Jersey.

[fol. 356] IN THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF NEW JERSEY

In the Matter of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, Debtor

In Proceedings for the Reorganization of a Railroad

No. 29778

Order No. 72 Directing the Trustees to Pay Certain Amounts on Account of New Jersey State Taxes for Which the Debtor Is Directly or Indirectly Liable

Shelton Pitney and Walter P. Gardner, Trustees of the property of the Debtor having filed their petition praying for authority to pay certain amounts on account of taxes assessed for the year 1940 by the State of New Jersey against the properties of the Debtor and of certain other companies referred to in said Petition, and the matter coming on to be heard on the return day of Order No. 71 to Show Cause entered herein on November 25, 1940, and all parties to this proceeding having been heard or given

an opportunity to be heard, and the Court having considered the same,

It is, on this 2nd day of December, 1940, Ordered that the Trustees be, and they hereby are, authorized to pay to the State of New Jersey the several amounts set forth below on account of taxes assessed for the year 1940:

[fol. 357]

Property of	*Amount of Taxes to be Paid*
The Debtor	$1,981,927.91
The Dover & Rockaway Railroad Company	2,323.76
The Ogden Mine Railroad Company	833.32
The New York & Long Branch Railroad Coinpany	44,986.43
The Bay Shore Connecting Railroad Company	671.36

and

It is further ordered that no payment or payments pursuant to the provisions of this Order shall constitute an affirmation or adoption of any lease, joint facility contract, or other contract or agreement pursuant to the terms of which any such taxes are paid or advanced, and

It is further ordered that if the State of New Jersey shall file claim in this proceeding for the taxes assessed by it against the property of the Debtor for the year 1940, and if such claim, as finally allowed, shall be less than the sum herein directed to be paid by the Debtor on its own account, any such excess shall be credited against any taxes hereafter assessed against the Debtor. In the event that no claim is filed or allowed for such taxes, then the entire amount herein directed to be paid shall be credited to any taxes hereafter assessed against the said property of the Debtor by the State of New Jersey.

Nothing herein contained shall be so construed as to be a decision of the issues which may be involved as to the validity of the assessments or as to the amount or legality of the taxes. No interest or penalties shall accrue on the amount herein directed to be paid for any period of time after payment thereof.

[fol. 358] The right is reserved to the Attorney General, in the event he concludes that a greater proportion of the

Debtor's 1940 taxes, as assessed, should be paid, to appear before this Court on December 16, 1940 at 10:30 A. M. without further notice, and so move.

Guy L. Fake, United States District Judge.

Filed December 2, 1940.

[fol. 359] IN THE UNITED STATES DISTRICT COURT, DISTRICT OF NEW JERSEY

In the Matter of CENTRAL RAILROAD COMPANY OF NEW JERSEY, Debtor

No. 29778

On Reorganization under Section 77 of the Bankruptcy Law

Reply of Claimant, State of New Jersey, to Trustees' Objections to Tax Claims

The joint reply of the State of New Jersey, claimant herein, to the several separate objections of said Trustees filed March 3, 1941, to proofs of claim filed December 11, 1940, for unpaid taxes levied by the State of New Jersey upon the property and franchise of the Debtor, and the several subsidiary or affiliated companies whose properties and franchises are in the possession of, and are operated by said Trustees as part of the Debtor's railroad in New Jersey, respectfully shows.

I

Claim No. 38—Central Railroad Company of New Jersey, Debtor

1. It denies all of that part on pages 1 to 6, inclusive under the heading "As to the taxes generally for the years 1932 to 1939, inclusive," except that it admits the payments on account of said taxes in the amounts shown [fol. 360] on Schedule "A" attached to the proof of claim, and it admits paragraphs (o) (p. 5), and (p) (p. 6).

2. It denies paragraphs numbered 1 to 3, inclusive (p, 16).

3. It denies paragraph 4 (pp. 6-7), and says that said appeals have been heard by the State Board of Tax Ap-

peals, but no decision has yet been rendered. It further says that the railroad tax act R. S. 54:26-13 provides:

> "In any suit or proceeding except on such complaint, before the state board of tax appeals or on such certiorari, the certificate and report of the state tax commissioner shall be conclusive and shall have the force and effect of a judgment of a court of record having competent jurisdiction and the proceeding whereon such certificate and report are founded, shall not be inquired into.";

that notwithstanding the pendency of said appeals before the State Board of Tax Appeals, the taxes, as levied against said company by the State Tax Commissioner in his certificates and reports, constitute valid prior liens upon its property, and are due and payable, and in default, in the amounts so levied, unless and until modified or reduced by legal judgment of a board or court of competent jurisdiction.

It further shows:

4. The company against which said taxes were levied is a railroad corporation organized and existing under and by virtue of the laws of the State of New Jersey; its property and franchise in New Jersey are taxable for the support of the government of said state, and the municipal subdivisions thereof in which said property is located, under the provisions of an act of the legislature [fol. 361] of said state entitled "An Act to revise and amend 'An Act for the taxation of a railroad and canal property,' approved April tenth, one thousand eight hundred and eighty-four," approved March 27, 1888 (N. J. P. L. 1888, ch. CCVIII, p. 269), and the various amendments and supplements thereof, now incorporated in chapters 19 to 29, inclusive of title 54 of the Revised Statutes; that said property and franchise were duly and lawfully assessed for taxes, in accordance with the constitution and laws of New Jersey, for each of the years of 1932 to 1939, both inclusive and the taxes in question were duly and lawfully levied thereon, and there remains due and unpaid taxes and interest in the amounts shown on Schedule "A", respectively, attached to the proof of claim filed herein, subject to lawful interest on the amount of said taxes,

from and after December 1, 1940, until paid, at the rate of one per cent per month as set forth in said proof of claim.

5. Said acts provide that taxes so levied shall be liens paramount to all other liens upon all the lands, tangible property and franchise of the company against which they are levied, effective on the first day of November of the calendar year for which said taxes are levied (N. J. P. L. 1888, p. 274); that if any portion of said taxes shall remain unpaid on the first day of December following the levying thereof, such company shall be considered in default, and such taxes, or the unpaid portion thereof, shall thenceforth bear interest at the rate of one per centum for each month until paid (N. J. P. L. 1922, p. 14).

6. Said unpaid taxes and interest are legally due and owing to claimant and are required by law to be paid by the Trustees, in advance of the payment of other claims, in the order of priority specified in section 64 of the bankruptcy law (11 U. S. C. A., sec. 104, p. 123).

[fol. 362] 7. In the several proceedings set forth in Schedule "C", attached to the proofs of claim, respectively, which are incorporated herein by reference as if repeated in full in this reply, the same causes of action and grounds of complaint as set forth in the Trustees' objections, were alleged and urged in legal proceedings to contest the assessments and taxes levied for each of said years, before the State Board of Tax Appeals, the New Jersey Supreme Court, this Court, the United States Circuit Court of Appeals, Third Circuit, and the Supreme Court of the United States. In each of said proceedings the same rights, facts and matters were put in issue, or were necessarily involved and were adjudicated, therein as are claimed, alleged and set forth in the Trustees' objections filed herein. The said causes of action were between the same parties in interest, or their privies, as the parties in interest, and the same taxes involved, in this proceeding. In each of said proceedings the State Board of Tax Appeals and each of the above mentioned courts, was a court of record of competent jurisdiction to hear and determine the alleged causes of action, and all rights, facts and matters, and all questions of law and fact pertaining thereto, which were in issue, or necessarily involved, in said proceedings, including the validity and amount of the assessments and taxes in question, and

the claim of illegel discrimination. In each of said proceedings all of said issues of fact and law, which are the same issues of fact and law set forth in said objections in this proceeding, and the amount and validity of said taxes so levied were heard and argued, and adjudicated by final judgments or decrees of said Board and Courts, respectively against said railroad company and in favor of the claimant herein, the real party in interest in said proceedings and in this proceeding.

8. The official reports of the decisions in said proceedings, respectively, are correctly set forth in Schedule "C", at-
[fol. 363] tached to the proofs of claim, except that the decision of the Circuit Court of Appeals, Third Circuit, referred to in paragraph (d) with respect to 1932 and 1933 taxes, is reported as Lehigh Valley Railroad Company *v.* J. H. Thayer Martin, State Tax Commissioner, et als., 100 Fed. (2d) 139, and the decision of that court referred to in paragraph (b) with respect to 1934, 1935 and 1936 taxes, is reported as Central Railroad Company *v.* J. H. Thayer Martin, State Tax Commissioner, et als., 115 Fed. (2d) 968.

9. All of said final judgments and decrees (except the decrees of the United States Circuit Court of Appeals, Third Circuit, entered November 27, 1940) were entered and became effective prior to the filing of Debtor's petition in this proceeding.

10. All of the unpaid taxes claimed in the proof of claim accrued and became prior liens upon the property and franchise assessed, and were due, payable and in default before the filing, on October 30, 1939, of the Debtor's petition for reorganization, except that the taxes for 1939, although fully assessed and levied before that date, attached as a prior lien upon said property and franchise on November 1, 1939, and became due and payable, and were in default after, December 1, 1939.

11. All of the grounds of objection stated, and all of the issues of fact and law raised, or necessarily involved, in said objections, with respect to the amount or validity of said assessments and taxes are res judicata in this proceeding.

12. This court has no jurisdiction, power or authority to make a new assessment or tax levy, or to revise or reduce the amount of the assessments or taxes, or any of them, or to abate or reduce the amount of the legal interest which has

[fols. 364-365] accrued, or which may hereafter accrue, to date of final payment, upon the amount of taxes in default on any due date, as prescribed by the railroad tax acts of the State of New Jersey.

[fol. 366] Wherefore Claimant prays for the dismissal of said objections, and each of them, and for allowance of the full amount of each of said claims and interest as set forth in Schedule "A" attached thereto, respectively, together with interests on said taxes, respectively, at the rate of 1% per month and after December 1st, 1940.

David T. Wilentz, Attorney General, Attorney for Claimant, State of New Jersey, State House, Trenton, New Jersey.

March 26, 1941.

[fol. 367] IN THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF NEW JERSEY

In the Matter of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, Debtor

In Proceedings for the Reorganization of a Railroad

No. 29,778

Petition of the Trustees of the Debtor for Authority to Compromise, Pursuant to Chapter 290 of the Laws of New Jersey of 1941, Certain Taxes Levied by the State of New Jersey for the Years 1932 to 1940, Inclusive, on Properties of the Debtor and Its Subsidiaries, Comprising the Railway System of the Debtor Operated by the Trustees of the Debtor in the State of New Jersey, for an Adjudication of the Amount Thereof, and for Authority to Pay the Same Pursuant to the Terms and Conditions of Said Act, and for Order No. 123 Thereon

To the Honorable Guy L. Fake, one of the Judges of the United States District Court for the District of New Jersey:

The petition of Shelton Pitney and Walter P. Gardner, Trustees, respectfully shows:

1. That this Court, by its Order No. 1, prohibited Debtor from making any payment on account of tax assessments

or other governmental charges, state or local, due or to [fol. 368] become due, and whether theretofore or thereafter assessed, upon its property or any thereof in the State of New Jersey without further Order of this Court.

2. That from time to time subsequent to said Order No. 1, this Court has authorized certain payments to be made on account of taxes assessed by the State of New Jersey upon the properties being operated by your petitioners, but that as of this date the principal amount of said taxes upon the properties of the Debtor's railroad system, as defined in the Act of the New Jersey Legislature hereinafter referred to, alleged to be due and which remained unpaid on July 22, 1941, is as follows:

The Central Railroad Company of New Jersey	$13,438,669.19
The Dover and Rockaway Railroad Company	15,185.44
The Ogden Mine Railroad Company	5,776.23

3. That on July 22, 1941, there became effective an Act of the Legislature of the State of New Jersey entitled "An Act relating to the collection of certain delinquent taxes upon railroad companies", (Chapter 290 of the Laws of New Jersey of 1941).

4. That this Act provides that the State Treasurer is authorized and required to accept, without interest penalties, installment payments of the full principal amount of property taxes upon railroad companies, which were due on or before December first, one thousand nine hundred and forty, and which remained unpaid on said effective date, provided that the delinquent taxpayer has complied with the requirements of Sections 7 and 8 of said Act.

5. That Section 7 of said Act permits any railroad or system, as defined in the Act, or the receiver, trustee or trustees thereof, to enter upon the execution of an installment payment plan authorized under the Act by duly executing [fol. 369] and filing with the State Comptroller a written undertaking, in such form as the Attorney General may prescribe, for the payment of the total amount of delinquent taxes owed by the railroad or system, and paying into the State treasury an amount not less than the first annual installment together with interest on the unpaid balance computed in the manner provided by the Act.

6. That Section 8 of the Act provides that the first payment tendered pursuant to the Act shall be accompanied by a waiver of any and all rights to contest the legality or amount of any assessments made prior to December first, one thousand nine hundred and forty-one, together with stipulations, consents or other papers for the discontinuance and dismissal of all suits, actions and proceedings pending in any court or before the Board of Tax Appeals concerning such assessments, all in such form as the Attorney General may require.

7. That said Act further provides that the total principal amount of delinquent taxes payable thereunder shall be paid in full in accordance with the formula set forth in said Act, and, in accordance with the terms of said formula and its application to the relevant figures of the railway system operated by your Trustees, said system will be required to pay said delinquents in not more than twenty (20) annual installments, if your petitioners are instructed to comply with the provisions of said Act.

8. That your petitioners believe that they should execute and file the undertaking provided for in said Section 7 and should pay on behalf of the railroad and system operated by them under the direction of this Honorable Court, the first annual installment of said delinquent taxes as defined under said Act, insofar as the properties of the Debtor itself are concerned, and in the case of the properties of The Dover and Rockaway Railroad Company and The [fol. 370] Ogden Mine Railroad Company, they should be authorized, in their discretion, to pay the full amount of the principal of said delinquent taxes as defined under said Act, all of said payments to be made, together with interest at three percent from December 1, 1940, as prescribed in said Act, and that the tender of said payments, pursuant to said Act, should be accompanied by a waiver or waivers of any and all rights to protest the legality or amount of any assessment made prior to December first, one thousand nine hundred forty-one, together with stipulations, consents and other papers for the discontinuance and dismissal of all suits, actions and proceedings pending in any court or before the Board of Tax Appeals concerning said assessments, as provided for or permitted by said Act.

9. That your petitioners have drafted and attach hereto (1) as Exhibit 1, a form of undertaking to be executed and filed by them with the State Comptroller of the State of New Jersey pursuant to the provisions of Section 7 of said Chapter 290 of the Laws of New Jersey of 1941, and (2) as Exhibit 2, a form of waiver to be executed and delivered by them with the said payments, or tender of payment, pursuant to the provisions of said chapter, and they respectfully recommend that they be authorized to execute, file and deliver instruments in substantially the form of such attached forms of undertaking and waiver, with such amendments and further instruments, stipulations, consents, or other papers as may be prescribed or required in accordance with said Chapter 290 of the Laws of New Jersey of 1941.

Wherefore, your petitioners respectfully pray:

1. That this Court may find and determine the amount of delinquent taxes due to the State of New Jersey from the Debtor, The Dover and Rockaway Railroad Company, and The Ogden Mine Railroad Com-
[fol. 371] pany, comprising the railway system operated by your petitioners, as defined in Chapter 290 of the Laws of New Jersey of 1941.

2. That this Court may order and direct your petitioners to compromise the total amount of delinquent taxes levied by the State of New Jersey, hereinbefore set forth, pursuant to the terms and conditions of Chapter 290 of the Laws of New Jersey of 1941.

3. That your petitioners be authorized and directed to take such further action as may be necessary to avail themselves of the provisions of said Chapter 290 of the Laws of New Jersey of 1941, and to execute any undertaking or undertakings, waiver or waivers, including an undertaking and a waiver in substantially the forms annexed hereto, and any other necessary or proper stipulations, consents or papers, and, insofar as the properties of the Debtor itself are concerned, to make such first payment or tender thereof, and in the case of the properties of The Dover and Rockaway Railroad Company and The Ogden Mine Railroad Company to make such full payments, as may be required

under the provisions of said Act, all of such payments to be made together with interest at three percent from December 1, 1940, computed in the manner prescribed in said Act.

And your petitioners will ever pray, etc.

Shelton Pitney, Walter P. Gardner, Trustees

Dated: August 7, 1941.

Filed: August 8, 1941.

(Verification dated August 7, 1941 omitted in printing.)

[fol. 372] EXHIBIT 1

Undertaking by Shelton Pitney and Walter P. Gardner, Trustees of the Property of The Central Railroad Company of New Jersey

Pursuant to the provisions of Chapter 290 of the Laws of New Jersey of 1941, and for the considerations mentioned therein, Shelton Pitney and Walter P. Gardner, as Trustees of the property of The Central Railroad Company of New Jersey, a corporation of the State of New Jersey, which property is being operated by them as a railroad system reporting to the Interstate Commerce Commission, for themselves and all of the railroad companies whose railroads are included in said railroad system, as defined in said Chapter 290 of the Laws of 1941, hereby undertake and agree to pay the State of New Jersey, in the manner, at the time or times, and within the period or periods, provided by said Chapter 290 of the Laws of New Jersey of 1941, the total principal amount of taxes on the property of said railroad system and all companies whose railroads are included in said system, as defined in said Act, which were due on or before December 1, 1940, and which remain unpaid, together with interest to be computed from and after the 1st day of December, 1940, at the rate of three percent per annum, on the balance of principal due at the time of making such payment.

The obligations of said Trustees of the property of The Central Railroad Company of New Jersey under this undertaking and agreement, shall be obligations of said Trustees solely as Trustees of the property of said The Central

Railroad Company of New Jersey, Debtor, and not individually. The obligations of the Trustees hereunder shall [fol. 373] be assumed by The Central Railroad Company of New Jersey or any other corporation or any receiver or receivers in equity that shall succeed to the Trustees in the possession of the property of the Debtor's Estate, whether pursuant to any plan of reorganization under Section 77 of the Bankruptcy Act or otherwise.

This undertaking and agreement has been approved by Order No. —, dated August —, 1941, of the United States District Court for the District of New Jersey, in proceedings for the reorganization of a railroad, In the Matter of The Central Railroad Company of New Jersey, Debtor, No. 29,778, a copy of which Order is hereto annexed.

The undersigned Trustees hereby further agree that they will execute and file, or cause to be executed and filed, with the State Comptroller of the State of New Jersey, such other or further written undertaking or undertakings as may be prescribed by the Attorney General pursuant to said Chapter 290 of the Laws of New Jersey of 1941.

In Witness Whereof, said Shelton Pitney and Walter P. Gardner, as Trustees of the property of The Central Railroad Company of New Jersey, have hereunto set their hands this — day of August, 1941.

Shelton Pitney and Walter P. Gardner, Trustees of the property of The Central Railroad Company of New Jersey. Shelton Pitney. Walter P. Gardner.

Witness: —— ——.

The undersigned railroad companies, owners of property leased by them to The Central Railroad Company of New [fol. 374] Jersey and operated as part of the railroad system being operated by Shelton Pitney and Walter P. Gardner, as Trustees of said The Central Railroad Company of New Jersey, hereby consent to and join in the foregoing undertaking.

The Dover and Rockaway Railroad Company by E. W. Scheer, President.

Attest: —— ——.

The Ogden Mine Railroad Company by E. W. Scheer, President.

Attest: —— ——.

[fol. 375] Exhibit 2

Waiver

Pursuant to the provisions of Chapter 290 of the Laws of New Jersey of 1941, and for the considerations therein mentioned—

Shelton Pitney and Walter P. Gardner, as Trustees of the property of The Central Railroad Company of New Jersey,
The Central Railroad Company of New Jersey,
The Ogden Mine Railroad Company, and
The Dover and Rockaway Railroad Company,

constituting the system of The Central Railroad Company of New Jersey in the State of New Jersey, as defined in said Act, do hereby severally waive any and all rights to contest the legality or amount of any assessment made prior to December 1, 1941, upon or against any or all of their respective properties used for railroad purposes in the State of New Jersey.

The aforesaid Trustees and Companies severally agree to execute and deliver any other or further waivers of said rights as may be required or prescribed by the Attorney General pursuant to the provisions of said Act.

In Witness Whereof said Trustees and each of said Companies have caused this instrument to be duly executed this — day of August, 1941.

Shelton Pitney and Walter P. Gardner, as Trustees of the property of The Central Railroad Company of New Jersey, by Shelton Pitney, Walter P. Gardner.

—— ——, Witness.

[fol. 376] The Central Railroad Company of New Jersey, by E. W. Scheer, President. (Seal.)

Attest: —— ——.

The Ogden Mine Railroad Company, by E. W. Scheer, President. (Seal.)

Attest: —— ——.

The Dover and Rockaway Railroad Company, by E. W. Scheer, President. (Seal.)

Attest: —— ——.

[fol. 377] IN THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF NEW JERSEY

In the Matter of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, Debtor

In Proceedings for the Reorganization of a Railroad

No. 29,778

Order No. 123 Authorizing the Trustees of the Debtor to Compromise, Pursuant to Chapter 290 of the Laws of New Jersey of 1941, Certain Taxes Levied by the State of New Jersey for the Years 1932 to 1940, Inclusive, on Properties of the Debtor and Its Subsidiaries, Comprising the Railway System of the Debtor Operated by the Trustees of the Debtor in the State of New Jersey, Adjudicating the Amount Thereof, and Authorizing Payment of the Same Pursuant to the Terms and Conditions of Said Act.

On reading and filing the duly verified petition of Shelton Pitney and Walter P. Gardner, Trustees of the property of the Debtor, for authority to compromise certain taxes levied by the State of New Jersey for the years 1932 to 1940, inclusive, on properties of the Debtor, The Central Railroad Company of New Jersey, and its subsidiaries, The Dover and Rockaway Railroad Company and The Ogden [fol. 378] Mine Railroad Company, which together constitute the "railroad system" of the Debtor operated by the Trustees of the Debtor in the State of New Jersey, as "railroad system" is defined in Chapter 290 of the Laws of the State of New Jersey for the year 1941, for an adjudication of the amount of said taxes, and for authority to compromise and pay said taxes, and the Court having heard said Trustees and being fully advised in the premises, the Court finds, adjudicates and decrees:

That the principal amounts of taxes assessed and levied for said years against The Central Railroad Company of New Jersey or its Trustees by the State of New Jersey, and against The Dover and Rockaway Railroad Company and The Ogden Mine Railroad Company, on the properties

in New Jersey of the several companies, are respectively as follows:

Company	*Tax Due*
The Central Railroad Company of New Jersey	$13,438,669.19
The Dover and Rockaway Railroad Company	15,185.44
The Ogden Mine Railroad Company	5,776.23

And that pursuant to Chapter 290 of the Laws of New Jersey of 1941, no interest penalties are due on any of said delinquencies in the event that the compromise provided for by said chapter is duly accepted and said taxes are paid pursuant to such compromise and to the terms and conditions of said Chapter 290.

It is, on this 8 day of August, 1941, Ordered that Shelton Pitney and Walter P. Gardner, as Trustees of the property of the Debtor, shall settle and compromise, and pay the delinquent taxes levied by the State of New Jersey, [fol. 379] hereinabove set forth, pursuant to the terms and conditions of Chapter 290 of the Laws of New Jersey of 1941; that the said Trustees be and hereby they are authorized to execute and file or tender an undertaking and a waiver substantially in the forms attached to the petition of said Trustees to this Court, with such other undertakings, waivers, stipulations, consents and papers as may be prescribed or required to carry out the provisions of said Chapter 290 of the Laws of New Jersey of 1941; that the obligations of said Trustees of the property of The Central Railroad Company of New Jersey under said undertaking and agreement or under any undertaking, agreement or instrument executed and filed or tendered pursuant to this Order, shall be obligations of said Trustees solely as Trustees of the property of said The Central Railroad Company of New Jersey, Debtor, and not individually; that the obligations of the Trustees thereunder shall be assumed by The Central Railroad Company of New Jersey, or any other corporation, or any receiver or receivers in equity that shall succeed to the Trustees in the possession of the property of the Debtor's Estate, whether pursuant to any plan of reorganization under Section 77 of the Bankruptcy Act or otherwise; and

It is Further Ordered that the Trustees be and hereby they are authorized, insofar as the properties of The Central Railroad Company of New Jersey are concerned, presently to tender and pay one-twentieth (1/20) of the total amount of taxes due, and in the case of the properties of The Dover and Rockaway Railroad Company and The Ogden Mine Railroad Company presently to tender and pay the full amount of the principal of said delinquent taxes as defined under said Act, each of said payments to be made with interest at three percent. per annum from [fol. 380] December 1, 1940, to the date of payment, as prescribed in said Act, and to be accompanied by such undertaking and waiver or waivers, and other or supplemental papers for the discontinuance and dismissal of all suits, actions and proceedings pending in any court or before the Board of Tax Appeals, or otherwise, concerning said assessments, as may be necessary or proper in order to comply with the provisions of said Act.

Guy L. Fake, United States District Judge.

Filed: August 8, 1941.

[fol. 381] IN THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF NEW JERSEY

In the Matter of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, Debtor

In Proceedings for the Reorganization of a Railroad

No. 29,778

Petition of Trustees for Order No. 135 Instructing Them Concerning Payment to the State of New Jersey of Taxes Levied Against the Debtor and Certain of Its Affiliated Companies for the Year 1941

To the Honorable Guy L. Fake, Judge of the District Court of the United States for the District of New Jersey:

The petition of Shelton Pitney and Walter P. Gardner, Trustees, respectfully shows:

1. The State of New Jersey, under Chapter 291 of the Laws of 1941, has levied property taxes against the Debtor

and certain of its affiliated companies, which taxes are due and payable on December 1, 1941, as follows:

[fol. 382] *Company*	*Amount*
The Debtor	$2,010,218.76
The Dover and Rockaway Railroad Company	2,368.98
The Ogden Mine Railroad Company	971.28
The New York and Long Branch Railroad Company	44,603.25*
The Bay Shore Connecting Railroad Company	709.86†
Total	$2,058,872.13

* This represents one-half of the amount levied, the other half being payable by The Pennsylvania Railroad Company.

† This represents one-half of the amount levied, the other half being payable by The Lehigh Valley Railroad Company.

No franchise tax is payable by any of said companies for the year 1941.

2. The aforesaid taxes, as provided by Sections 7 and 73 of Chapter 291 of the Laws of 1941, were computed by applying the tax rate of 3% upon the following values of the tangible property of said Companies as said values were assessed under Chapters 19 to 29 inclusive of Title 54 of the Revised Statutes:

Company	*Amount*
The Debtor	$67,007,292.00
The Dover and Rockaway Railroad Company	78,966.00
The Ogden Mine Railroad Company	32,376.00
The New York and Long Branch Railroad Company	2,973,549.00
The Bay Shore Connecting Railroad Company	47,324.00

[fol. 383] 3. On June 6, 1941, by their Petition for Order #107, your Trustees reported that while no final assessments for the year 1941 had been served upon them, yet in view of the tentative assessments they had reason to

expect that said final assessments would be unlawful and under the terms of Revised Statute 54:26-7 any complaint against said assessed values must be filed with the State Board of Tax Appeals not later than June 16, 1941, and requested instructions. This Court, by Order #107, instructed that an appropriate complaint should be filed with said State Board and reserved for future consideration any questions that might arise as to the amount or legality of the taxes levied against the Debtor's property for the year 1941.

4. On June 11, 1941, under the authority of Order #107, your petitioners filed a complaint with the State Board of Tax Appeals alleging that the final values assessed on or about June 7, 1941, against the property of the Debtor, The Dover and Rockaway Railroad Company and The Ogden Mine Railroad Company, were arbitrary, excessive and discriminatory, in violation of the Constitution and Statutes of New Jersey and of the Fourteenth Amendment to the Federal Constitution.

5. On July 22, 1941, Chapters 290 and 291 of the Laws of 1941 became effective.

6. Said Chapter 290 provides for the installment payment of the principal amount of delinquent taxes upon railroad companies without interest penalties. By Order No. 123, this Court authorized the Trustees of the Debtor to settle and pay pursuant to said Chapter 290 delinquent taxes levied by the State of New Jersey for the years 1932 to 1940, inclusive, on properties of the Debtor and its subsidiaries, comprising the railroad system of the Debtor operated by the Trustees of the Debtor in the State of New Jersey.

[fol. 384] Following the entry of said Order No. 123, the Trustees of the Debtor, in compliance with the terms thereof and with the terms and conditions of said Chapter 290, duly tendered payment to the Treasurer of the State of New Jersey of one-twentieth (1/20) of the total principal amount of delinquent taxes owed by the Debtor with interest computed in the manner prescribed by said Act; and also tendered payment to the Treasurer of the State of New Jersey the total principal amount of delinquent State taxes of The Dover and Rockaway Railroad Company,

together with interest computed in the manner prescribed by the aforesaid Act; and also tendered payment to the Treasurer of the State of New Jersey the total principal amount of delinquent State taxes of The Ogden Mine Railroad Company, together with interest computed in the manner prescribed by the aforesaid Act.

In further compliance with the terms of said Order No. 123 and with the terms and conditions of said Chapter 290, the Trustees of the Debtor filed with the Comptroller of the State of New Jersey, on behalf of the Debtor and its subsidiaries, an "Undertaking by Shelton Pitney and Walter P. Gardner, Trustees of the Property of The Central Railroad Company of New Jersey" providing for the payment of taxes due for the years 1932 to 1940, inclusive, with interest as prescribed by said Act, and said Trustees filed with the Treasurer of the State of New Jersey a waiver of all rights to contest the legality or amount of any assessment made prior to December 1, 1941, and stipulations and consents for an order of discontinuance of the appeals pending before the New Jersey Board of Tax Appeals for the years 1939, 1940 and 1941.

Up to this date, neither the Trustees of the Debtor nor the Debtor have received any communication advising that said tender has been rejected nor have the certified checks tendered and delivered to the Treasurer of the State of New Jersey on August 11, 1941, been returned. The Attorney General of the State of New Jersey, how-[fol. 385] ever, has filed a Civil Information and an Amended Civil Information contesting the validity of said Chapter 290 of the Laws of New Jersey of 1941. Said Civil Information and Amended Civil Information are still pending and undetermined before the Court of Chancery of New Jersey.

In view of the foregoing, the Trustees do not believe that they should further contest the validity, at this time, of the valuations of the tangible property of the Debtor and said affiliates for the year 1941, which valuations were fixed under the former law but made applicable by Section 73 of Chapter 291 in computing the 1941 tax.

7. Chapter 291 of the Laws of New Jersey of 1941, above referred to, repealed Chapters 19 to 29 inclusive of Title 54 of the Revised Statutes which had theretofore

prescribed the taxes payable on railroad-used property and provided that beginning with the year 1941 each railroad company should be assessed (1) a tax of 3% upon the true value of all its railroad-used property, and (2) a franchise tax of 3% upon the "excess of the franchise base," computed as prescribed in Section 15 of said Act.

Under Chapter 291 the property taxes specified in paragraph 1 above have been levied by the State against the property of the Debtor and certain of its affiliated companies. No franchise taxes have been accrued against the Debtor of any of said companies for the current year, owing to the fact that there is no "excess of the franchise base" subject to said franchise tax for the year 1940.

It is impossible at this time to determine the amount of the franchise tax which may be levied for the year 1942. Depending upon interpretations of Chapter 291, it may be that for the year 1942, if no additional remedial legislation is enacted, the combined property and franchise taxes which will be assessed against the Debtor for the year 1942 may exceed that which would have been levied or payable under the former law.

[fol. 386] The Legislature, on November 14, 1941, enacted New Jersey Assembly Bill #592, which deferred the accrual and payment date of the franchise tax for 1941 to December 15th, and on the same date adopted a Concurrent Resolution directing the Joint Legislative Committee to make a study of the operation of the 1941 railroad tax laws and to make a report thereon to the present session of the Legislature, and authorizing said Committee to make any recommendations to the Legislature which will in any way tend to improve the administration thereof or make more certain the attainment of the objectives sought by the Legislature in the passage of said laws.

One of the objectives of said legislation was to so revise the railroad tax law that taxes on the railroads would be reduced, at least with respect to those railroads which were having difficulty in meeting operating expenses (Report to Governor Charles Edison on Railroad Taxation in New Jersey, dated February 22, 1941, p. 21).

8. Your petitioners submit this summary of recent developments respecting the Debtor's New Jersey tax liability because this question is one of the chief factors in deter-

mining the ability of the Debtor to amortize the installments of back taxes, provide adequate capital improvements in order to serve the public and to meet the various safety and operating requirements of the Interstate Commerce Commission, and provide a basis of reorganization which would meet the requirements of said Commission and of this Honorable Court.

Your Trustees believe that upon a final decision upholding the validity of Chapter 290, providing for the settlement of delinquent taxes, and with amendments which may be adopted to the railroad tax act contained in Chapter 291, the Debtor's aggregate annual New Jersey taxes for the future may be sufficiently reduced to enable the Debtor to amortize the installments of back taxes, to meet the requirements of the service and to provide a proper basis of reorganization.

[fol. 387] In view of the fact that various aspects of these matters are still under study by the Court of Chancery and by the Legislature, your Trustees believe that they should recommend to this Honorable Court the payment in full, without prejudice, of the taxes levied against the Debtor and the affiliated companies referred to in this petition for the year 1941, even though the assessed values placed on the railroad-used property of the Debtor and said affiliated companies are deemed to be excessive.

Wherefore, your petitioners respectfully pray that they may have the aid and instructions of this Honorable Court in the premises, and that they may be authorized and directed to make payment on or before December 1, 1941, of the amount of the taxes levied against the Debtor and the affiliated companies named herein as set forth in paragraph 1 of this petition;

And they further pray that the Order to be made by this Honorable Court on this petition be made without prejudice as to any question which the Debtor or its Trustees may be advised at any time to raise with respect to the interpretation, legality or constitutionality, or otherwise, of Chapter 291 of the Laws of 1941, or of any laws which were repealed by said Chapter 291, and also without prejudice as to any question which the Debtor or its Trustees may be advised at any time to raise as to the validity or propriety of any valuations or taxes which have been or may hereafter

be placed or levied on the properties of the Debtor or of any of its affiliated companies under any of said laws.

Shelton Pitney and Walter P. Gardner, Trustees of the Debtor, by Shelton Pitney.

Dated: November 18, 1941.
Filed: November 21, 1941.

(Verification dated Nov. 18, 1941 omitted in printing.)

[fol. 388] IN THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF NEW JERSEY

In the Matter of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, Debtor

In Proceedings for the Reorganization of a Railroad

No. 29,778

Minutes of Hearing, Newark, N. J., Monday, November 24, 1941.

On Petition of Trustees for Order instructing them concerning payment to the State of New Jersey of taxes levied.

Before Hon. Guy L. Fake, U. S. D. J.

APPEARANCES:

SHELTON PITNEY, Esq., a Trustee,
HOWARD L. KERN, Esq., and WILLIAM F. HANLON, Esq., for the Debtor.
ISRAEL B. GREENE, Esq., by
BERNARD PROTZEL, Esq., of Counsel for the City of Bayonne.
HOVEY C. CLARK, Esq., for Central Hanover Bank & Trust Co., Trustee.
ROBERT CAREY, JR., Esq.,
MESSRS. SHOENHOLZ & SHOENHOLZ, by
MILTON SHOENHOLZ, Esq., for the Brooks Bondholders Committee.

[fol. 389] Mr. Pitney: With the Court's permission, for the purpose of presenting this motion to the Court I would

like to move the admission of Howard L. Kern of the New York bar, and general counsel of the Debtor.

The Court: Granted.

Mr. Kern: May it please the Court, this petition of the Trustees is for an order instructing them concerning payment to the State of New Jersey of property taxes levied for the year 1941.

The Court: It has not required any notice, has it?

Mr. Kern: We served notice, your Honor.

The Court: Is there anyone appearing for the State? Apparently not.

Mr. Kern: Due notice was served and proof of service has been filed with the Clerk of the Court. These taxes are levied for the year 1941 against the properties of the Debtor and also of certain subsidiary and affiliated companies: The Dover & Rockaway Railroad Company, the Ogden Mine Railroad Company, the New York & Long Branch Railroad Company, and the Bay Shore Connecting Railroad Company. The amount of the tax for the Debtor for the year 1941 is $2,010,218.76; for the Dover & Rockaway Railroad Company, $2,368.98; for the Ogden Mine Railroad Company tax, $971.28; and as to the New York & Long Branch Railroad Company the amount payable by the Debtor is $44,603.25, an equal amount being payable by the Pennsylvania Railroad; and as to the Bay Shore Connecting Railroad Company, the amount of the tax for 1941 is $709.86, half the amount being paid by the Lehigh Valley Railroad Company, as this is jointly owned.

The assessment of the above tax is based upon the valuations set forth in the petition. I won't read all those, but the total valuation of the property of the Debtor as shown in the petition is $67,007,292. Now, these valuations are substantially the same as those referred to in a petition which was filed by the Trustees with your [fol. 390] Honor on June 6, 1941, asking for instructions as to whether a complaint should be filed with the State Board of Tax Appeals; and by Order No. 107 your Honor instructed the Trustees to file such a complaint, and such a complaint was filed as to the amount of this assessment on the properties of the Debtor.

Subsequent to the filing of this complaint, on July 22, 1941, the Legislature enacted the Tax Settlement Act, which is Chapter 290 of the Laws of 1941, and also the Railroad Tax Act, which is Chapter 291 of the Laws of

1941. Now, Chapter 290, briefly stated, provided for the installment payment of the principal amount of delinquent taxes upon railroad companies without interest penalties, providing the terms and conditions of said Chapter 290 were complied with by the company so taxed. The formula provided in Chapter 290 to determine the amount of the installments of delinquent taxes required the payment, in the case of the Debtor, within a period of twenty years and not less than one-twentieth thereof each year.

Among the conditions to be complied with to make effective the Tax Settlement Act under Chapter 290 was the condition that the railroad company must tender the installment provided by the formula on or before December 1, 1941 of each year, and must accompany the first tender with a waiver of all rights to contest the legality or amount of any assessment made prior to December 1, 1941, simultaneously filing with the State Comptroller a written undertaking, in such form as the Attorney General shall prescribe, for the payment of the total amount of delinquent taxes owed by the railroad company in the manner and installment amounts prescribed by the Act.

Order No. 123 was entered by your Honor on petition of the Trustees for authority to settle and pay the delinquent taxes of the Debtor for the years 1932 to 1940, and for the authority to file the undertakings, waivers, stipulations and consents required to carry out the provisions of said Tax Settlement Act, the said Chapter 290. In this [fol. 391] order your Honor found the principal amount of the taxes which had been assessed and levied for the years 1932 to 1940 against the Debtor and which remained unpaid, and found that upon payment of the installment provided by said Act and complying with the other provisions of the Act, no interest penalties would be due, and authorized the Trustees to tender one-twentieth of the total amount of said delinquent taxes of the Debtor, such tender to be accompanied by such undertakings, waivers, stipulations and consents as might be required under the provisions of said Tax Settlement Act.

I shall present a witness in a moment, your Honor, who will testify as to the papers which have been filed with the State Treasurer and the State Comptroller, and as to the making of said tender authorized by your Honor in Order No. 123. However, before presenting such witness I wish to state to your Honor the reason why the

Trustees are recommending payment of the principal amount of the property taxes of the Debtor for the year 1941, which are due and payable on December 1, 1941 as above set forth. That reason is that we filed a waiver with the tender of the first installment of the delinquent taxes under the Tax Settlement Act. That waiver provided that the Trustee waived any and all rights to contest the legality or amount of any assessment made prior to December 1, 1941 upon or against the properties of the Debtor which were used for railroad purposes in the State of New Jersey. Now, the present tax, as to which the Trustees are asking instructions and for which they are asking authority to make payment, was assessed prior to December 1, 1941, and is due and payable on that date.

But the Trustees, in asking this authority, have deemed it advisable to present your Honor the full facts as to the tender made and the undertakings, stipulations and waiver, filed pursuant to your Honor's Order No. 123, and to set forth clearly through witnesses the fact that neither the Trustees nor the Debtor nor any company affiliated with [fol. 392] the Debtor has received any communication from the Attorney General, the State Comptroller or the State Treasurer, advising that any such tenders have been rejected, nor have the certified checks which were tendered and delivered to the State Treasurer on August 11th been returned.

The Trustees have further set forth in the petition that the Attorney General has filed a Civil Information and an Amended Civil Information in the Court of Chancery of New Jersey to contest the validity of said Settlement Act, and this matter is still pending before the said court. Now, in view of all those facts the Trustees have asked for authority to pay the property taxes for the year 1941 in the amount set forth in Paragraph 1 of the petition, but at the same time have requested that any order, that may be made by your Honor on this petition, be made without prejudice as to any question which the Debtor or its Trustees may be advised at any time to raise with respect to the interpretation, legality or constitutionality or otherwise of Chapter 291 of the Laws of 1941, or any laws which were repealed by said Chapter 291.

The Court: How can the Court reserve such rights to you in the face of statutory requirements?

Mr. Kern: The Attorney General is a petitioner in this court for the amount of the taxes due. The Attorney General having contested the validity of the Tax Settlement Act in the Court of Chancery, this Court must necessarily reserve jurisdiction in the event there is any determination as to the propriety of the act, because our tender was made and the waiver was filed pursuant to an act which is now being contested as to its constitutionality. Therefore, the reservation asked is to protect the jurisdiction of this Court to determine the amount and the legality of the taxes in the event that the tender is not accepted because in that event our waiver would not be effective; and the Attorney General would be here to claim [fol. 393] the amount of the taxes alleged to be due and to have the amount determined by this Court. Therefore we are only asking that the reservation be made in order to protect the jurisdiction of the Court and not have any misunderstanding later on in the event the Act is held unconstitutional.

The Court: What sort of waiver did you sign?

Mr. Kern: The waiver is exactly in the form specified in the petition for Order 123 filed by the Trustees and is in the statutory form (Section 8 of the Tax Settlement Act). That was a waiver which the Statute required to accompany the tender.

The Court: It was broad enough to——

Mr. Kern: We waived the right to contest the validity or propriety of any taxes which have been assessed to December 1, 1941.

The Court: You had to do that before you took advantage of the Act.

Mr. Kern: Yes, that was required by Section 8 of the Act.

The Court: Now you want me to give you an order that will save you those rights which you have waived.

Mr. Kern: We aren't asking the Court to——

(Discussion aside with Mr. Pitney.)

I think the point that Mr. Pitney suggests is also pertinent: that we are reserving the right to contest the validity of Chapter 291 with respect to new taxes. But I also stated in my statement that we are also asking for an order that this is without prejudice as to the validity of any taxes assessed under previous laws which were

repealed by Chapter 291. So we are right back to that question as to whether this Court should now do anything that prejudges the whole question in the event that our tender is not accepted or that the law is declared unconstitutional.

Now, so far in my statement I have referred to properties of the Debtor. The evidence that we will introduce also will [fol. 394] relate to the other affiliated companies to which I have referred. The situation as to these affiliated companies is substantially the same except that in the case of some of these subsidiary companies, as will be shown, the amount of back taxes were paid in full, whereas in the case of the Debtor an installment of only one-twentieth of the principal amount of alleged delinquent taxes was tendered.

Now, the Tax Settlement Act provided that the undertaking and waiver and certain other papers should be in such form as the Attorney General shall prescribe. However, the Tax Settlement Act contemplates that conditions of tender, undertakings, waivers, and so forth shall be complied with on or before December 1 in each year. However, in so far as the Trustees have been able to learn, no forms have been prescribed by the Attorney General. The Trustees have drawn all of the forms and have submitted them together with the tender to the state officers, prescribed by statute.

The Court: That tender has been made?

Mr. Kern: Yes, and there has been no indication of any——

The Court: And no objection has been made to them?

Mr. Kern: Not as to the form of any papers.

The Court: And the receipts.

Mr. Kern: We have the receipts for the letters and documents tendered to the State Comptroller and to the State Treasurer, but we have received no receipt for the money. We tendered the money by letter with certified checks. They marked the letter tendering them, "Accepted," but they haven't returned the checks.

The Court: They have not cashed the check?

Mr. Kern: No, they haven't.

The Court: Is there no one here from the Attorney General's office for the State?

Mr. Kern: I haven't seen anyone.

[fols. 395-403] Now, a certified copy of Order No. 123 of this Court was filed with the tender, which was made on behalf of the Debtor and on behalf of the two companies, the Dover & Rockaway Railroad Company and the Ogden Mine Railroad Company, by the Trustees. Now, inasmuch as the Tax Settlement Act required not only the filing of a waiver of the right to contest the legality or amount of any assessment, but also stipulations and other papers for the discontinuance and dismissal of all suits, actions and proceedings pending in any court or before the Board of Tax Appeals, concerning certain assessments, the Trustees accordingly accompanied the tender to the State Treasurer with stipulations and consents for the discontinuance of tax appeals which were pending for the years 1939, 1940 and 1941, and they did not apply for certiorari proceedings as to taxes for the years 1937 and 1938 which would have been filed had it not been for the provisions of the Tax Settlement Act.

If it had not been for the Civil Information and the Amended Civil Information, filed by the Attorney General in the Court of Chancery, there would be no question now as to the propriety of paying, without qualification, the whole amount of the property taxes on the properties of the Debtor and the affiliated companies mentioned in the petition, in view of the stipulations, waivers and consents that have been filed. It is only because of the Civil Information which is pending that we are recommending now the reservation which I have just stated in the record, asking your Honor to make an order without waiving any of the rights as I have stated them and as set forth in the petition.

If your Honor has no further questions, we have witnesses to show the tenders made and the papers filed with the State Treasurer and State Comptroller.

* * * * * * *

[fol. 404] IN THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF NEW JERSEY

In the Matter of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, Debtor

In Proceedings for the Reorganization of a Railroad

No. 29,778

Order No. 135 Instructing the Trustees to Pay to the State of New Jersey on or Before December 1st Certain Taxes Levied Against the Debtor and Certain of Its Affiliated Companies for the Year 1941

Shelton Pitney and Walter P. Gardner, Trustees of the property of the Debtor, having filed their Petition praying for authority to pay certain taxes levied by the State of New Jersey for the year 1941 against the Debtor and certain other companies referred to in said Petition, and the matter coming on to be heard on notice duly served, and all parties to this proceeding having been heard or given an opportunity to be heard, and the Court having considered the same, and due cause having been shown,

The Court finds, adjudicates and decrees:

That the Trustees of the Debtor have taken all steps necessary on behalf of the Debtor's estate, and on behalf of its affiliated companies, The Dover and Rockaway Railroad Company and The Ogden Mine Railroad Company, [fol. 405] to comply with the provisions of Chapter 290 of the Laws of New Jersey of 1941, and have caused The New York and Long Branch Railroad Company and Bay Shore Connecting Railroad Company to take all steps necessary to comply with the provisions of said chapter; that no objection has been made either by the Comptroller, or the Treasurer, or the Attorney General of the State of New Jersey to the Trustees of the Debtor, or to the Debtor, or to any of said affiliated companies, or to this Court, as to the validity or form of any of the tenders, undertakings, waivers or stipulations filed by the Trustees, to comply with said Chapter 290, on behalf of the Debtor's estate and on behalf of its said affiliated companies; that the Trustees of the Debtor having so complied with the requirements of said Chapter 290 and having made due tenders pursuant to said chapter, accompanying said

tenders with waivers of any and all rights which they had to contest the legality or amount of any assessment made prior to December 1, 1941, upon the properties of the said Debtor and of said affiliated companies, and no objection having been filed to the entry of this order,

It is, on this 24th day of November, 1941, ordered that the Trustees be, and they hereby are, authorized to pay to the State of New Jersey, on or before December 1st, the several amounts set forth below on account of taxes assessed for the year 1941:

Company	*Amount of Taxes to be Paid*
The Debtor	$2,010,218.76
The Dover and Rockaway Railroad Company	2,368.98
The Ogden Mine Railroad Company	971.28
The New York and Long Branch Railroad Company	44,603.25
The Bay Shore Connecting Railroad Company	709.86

[fol. 406] and

It is further ordered that this order is made without prejudice to any question which the Debtor or its Trustees may be advised at any time to raise with respect to the construction, legality or constitutionality of, or the amount of any taxes levied after December 1, 1941, pursuant to, Chapter 291 of the Laws of 1941.

And it is further ordered that this order is made without prejudice to any question which the Debtor or its Trustees may be advised at any time to raise in the event that Chapter 290 of the Laws of 1941 is declared unconstitutional or in the event that said chapter is construed in any manner or in any respect inconsistent with the settlement made pursuant to said chapter and to Order No. 123 of this Court.

Guy L. Fake, United States District Judge.

Filed: November 24, 1941.

[fol. 407] IN THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF NEW JERSEY

In the Matter of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, Debtor

In Proceedings for the Reorganization of a Railroad

No. 29,778

Petition of the Trustees for Instructions Whether or Not they should Comply With Chapter 241 of the Pamphlet Laws of New Jersey of 1942* and for Order No. 161 Requiring the Attorney General, the Comptroller, and the Treasurer of the State of New Jersey, and All Other Parties, to Show Cause Why the Amount of the Tax Claim of the State of New Jersey Against the Debtor for the Years 1932 to 1939 Should Not Be Fixed at the Principal Amount of Taxes Alleged To be Due, Payable in the Manner, at the Time, With the Interest, and Upon the Terms and Conditions Prescribed by Chapter 241, and Why the Interest or Interest Penalties as Claimed by or on Behalf of the State of New Jersey in these Proceedings Should Not Be Disallowed

To the Honorable Guy L. Fake, One of the Judges of the District Court of the United States for the District of New Jersey:

The petition of Shelton Pitney and Walter P. Gardner, as Trustees of the property of The Central Railroad Company of New Jersey, respectfully shows that:

[fol. 408] 1. On or about December 10, 1940 the Honorable Frank J. Murray, Comptroller of the State of New Jersey, filed in this cause proof of claim No. 38, claiming that the Debtor owed to the State of New Jersey on account of unpaid taxes for the years 1932 to 1939, both years inclusive, a total of $12,117,450.68 plus alleged interest thereon in the sum of $7,732,339.50 and additional interest thereon from December 1, 1940 to date of payment. Your petitioners duly objected to said claims upon various grounds, to which objections reference is hereby made for

* See Order No. 163.

greater certainty. Your petitioners objected, inter alia, that no interest penalties could in any event be allowed against the Debtor's estate in view of the express prohibition contained in Section 57j of the Federal Bankruptcy Act against the imposition of penalties upon a bankrupt estate.

2. By Order No. 93 made and entered in this cause on April 1, 1941 said Claim No. 38 of the State of New Jersey was referred, with various other claims, to Augustus C. Studer, Jr., Esquire, as Special Master, together with all objections thereto, for hearing and report thereon in accordance with the provisions of said Order; and this Court expressly reserved the right to revise, alter or amend said Order. No report has been made by the Special Master on said Claim No. 38 and no hearing thereon has been held before him. Subsequent developments have made such a hearing and report unnecessary or impracticable, as from this petition will appear; and your petitioners allege that the emergency hereinafter disclosed requires that this Court take action with respect to said Claim No. 38 before June 15, 1942.

3. By Order No. 123 made and entered in this cause on August 8, 1941 this Honorable Court adjudicated and fixed at $13,438,669.19 the aggregate principal amount of the unpaid taxes levied and assessed by the State of New [fol. 409] Jersey against the Debtor or its Trustees for the years 1932 to 1940, both years inclusive. Said sum of $13,438,669.19 included the aforesaid total principal claim of the State of New Jersey against the Debtor for the years 1932 to 1939 inclusive, plus the excess of the taxes levied and assessed against the estate of the Debtor or its Trustees for the year 1940 over the amount paid by the Trustees on account thereof pursuant to the provisions of Order No. 72 made and entered in this cause on December 2, 1940.

4. By said Order No. 123 this Court also ordered your petitioners, as such Trustees, to settle, compromise and pay said aggregate principal amount of $13,438,669.19 of delinquent taxes in accordance with and in acceptance of the provisions of the then recently enacted Chapter 290 of the Pamphlet Laws of New Jersey of 1941 and authorized your petitioners to execute and file or tender the cer-

tain undertaking and waiver required by said Chapter together with all such other instruments as might be prescribed or required to comply therewith; and further authorized your petitioners to tender and pay the required first installment of one-twentieth of said aggregate principal amount of delinquent taxes of the Debtor and of the estate of the Debtor, together with interest on said aggregate principal amount at the rate of three per cent per annum from December 1, 1940 to the date of payment.

5. Your petitioners duly complied with said Order No. 123 and with said Chapter 290 and took all steps necessary or possible on their part in that behalf, including payment or tender of payment to the Treasurer of the State of New Jersey of $951,872.83 representing said required first installment on account of said delinquent taxes plus interest on said aggregate principal amount thereof at the rate of 3% per annum from December 1, 1940 to the date of said payment. Subsequently, by Order No. [fol. 410] 135 made and entered in this cause on November 24, 1941, this Court adjudicated and decreed that your petitioners had taken all steps necessary on behalf of the Debtor's estate to comply with the provisions of said Chapter 290 of the Pamphlet Laws of New Jersey of 1941.

6. Said Order No. 135 also directed your petitioners on or before December 1, 1941 to pay in full the taxes assessed against the Debtor by the State of New Jersey for the year 1941. The taxes so ordered to be paid had been levied and assessed under and by virtue of Chapter 291 of the Pamphlet Laws of New Jersey of 1941. As your petitioners represented to this Court in their petition for said Order No. 135 and as will appear from the 1941 levy and assessment and the bill presented by the State Tax Commissioner of the State of New Jersey, no franchise tax was levied or assessed against or was payable by the Debtor or its Trustees in and for said year 1941.

7. Your petitioners duly complied with said Order No. 135 and within the time thereby limited paid in full the taxes so levied and assessed against the Debtor by the State of New Jersey in and for the year 1941.

8. By Chapter 169 of the Pamphlet Laws of New Jersey of 1942, approved May 8, 1942, the franchise tax

provisions of said Chapter 291 of the Pamphlet Laws of 1941 were so amended that the franchise taxes payable under the 1941 law by certain other railroads in and for the year 1941 were reduced while, on the contrary, a retroactive franchise tax purportedly became assessable against the Debtor or its Trustees. Acting under and by virtue of said 1942 amendment the State Tax Commissioner of the State of New Jersey has now purported to levy and assess against the Debtor or its Trustees a retroactive franchise tax for the year 1941 amounting to $239,749.80.

[fol. 411] 9. By Chapter 241 of the Pamphlet Laws of New Jersey of 1942, approved May 21, 1942, Chapter 290 of the Pamphlet Laws of 1941 was amended so as to provide that any railroad taxpayer desiring to accept the provisions of the act must, on or before June 15, 1942, file with the State Treasurer a new and additional acceptance document and waiver in the form prescribed by the act, providing for the payment in full of the principal amount of all unpaid taxes for the years 1932 to 1940, both years inclusive, at the times and in the manner provided by the act, and waiving any and all rights to contest the legality or amount of any assessment on its property used for railroad purposes made prior to December 1, 1941 pursuant to the applicable tax acts. By the provisions of said Chapter 241 of the Pamphlet Laws of 1942 the acceptance document thereby required must also waive any and all rights to contest the legality or amount of any assessment "heretofore or hereafter made for the tax year one thousand nine hundred and forty-one". Said act also requires such taxpayer to file with the State Treasurer an additional consent to the discontinuance and dismissal of any and all suits, actions and proceedings pending in any court or before the State Board of Tax Appeals respecting any such assessments and at the same time to pay to the State Treasurer the initial installment payment provided for by the act, with interest as therein specified.

10. Said Chapter 241 of the Pamphlet Laws of New Jersey of 1942 makes no change in the number of installments in which the Debtor may pay the aggregate principal amount of its delinquent taxes for the years 1932 to 1940, both years inclusive, or in the amount of any install-

ment of principal, as compared with Chapter 290 of the Pamphlet Laws of 1941, but does require the taking of the various steps necessary to a compliance with the act and the making of the initial payment thereunder on or before June 15, 1942 and further requires that such initial [fol. 412] payment shall include interest at the rate of 3% per annum on the entire aggregate principal amount of tax delinquencies from December 1, 1940 to the date of such first installment payment, thus adding substantially to the amount of interest paid or tendered by your petitioners pursurant to the 1941 law and as directed by said Order No. 123.

11. Said Chapter 290 of the Pamphlet Laws of New Jersey of 1941 provided that the liens of the State of New Jersey for taxes and interest penalties of each year for which delinquent taxes were payable pursuant to said act should be fully satisfied and discharged, in the order in which such taxes accrued, when and as principal payments on account thereof should equal or exceed the full principal amount delinquent for any tax year, and when interest at 3% per annum upon all unpaid balances had been paid in full; and that upon default of all or part of an installment payment in any year or of interest upon the unpaid balance the whole remaining amount of delinquencies including interest penalt-es should, subject to the provisions aforesaid, be reinstated and become due and payable thirty days after the date of default. Said Chapter 241 of the Pamphlet Laws of New Jersey of 1942 provides in part, in lieu of the foregoing, as follows:

> "Upon default in the making of any payment provided for in the acceptance document, and a continuance thereof for a period of thirty days after the due date of such payment, the then remaining unpaid balance of taxes, together with statutory interest penalties with respect to any and all taxes assessed against such taxpayer or upon its property used for railroad purposes for any of the years one thousand nine hundred and thirty-two to one thousand nine hundred and forty, inclusive, calculated from the original due date of such taxes shall immediately be [fol. 413] come due and payable, and the State may assert, exercise and enforce any and all rights, claims, demands, liens and privileges with respect thereto as

if this act had not been enacted, and in addition thereto may assert and enforce any remedies it may have acquired under such acceptance document except that such taxpayer shall be entitled to a credit against such statutory interest penalties in an amount equal to the interest paid pursuant to the provisions of this act."

12. Said Chapter 241 of the Pamphlet Laws of New Jersey of 1942 also provides that should any such taxpayer so direct in the acceptance document filed pursuant to the act, the State Treasurer is authorized and required to collect the amount of any draft or check delivered to him by such railroad taxpayer pursuant to the provisions of Chapter 290 of the Pamphlet Laws of New Jersey of 1941 and to credit the same to the payments required to be made by such taxpayer under said Chapter 241.

13. Your petitioners are advised and therefore allege that grave doubts exist as to the legality and constitutionality of the purported retroactive levy and assessment against the Debtor or its Trustees under and by virtue of said Chapter 169 of the Pamphlet Laws of New Jersey of 1942 of any franchise or privilege tax for the year 1941, and, specifically, of the franchise tax amounting to $239,749.80 actually attempted to be so levied and assessed thereunder as aforesaid; that apart from the retroactive nature of said law and of said tax, and the payment in full as above set forth of all taxes assessed upon the estate of the Debtor for the year 1941, other grave doubts exist as to the legality and constitutionality of the franchise tax provisions of Chapter 291 of the Pamphlet Laws of New Jersey of 1941, as amended by said Chapter 169 of the Pamphlet Laws of New Jersey of 1942, as said provisions apply to the Debtor, because of the discriminatory opera- [fol. 414] tion and effect of said Laws upon the Debtor's business and property and their failure to provide for the deduction from the Debtor's net railway operating income of the amounts paid by order of this Court for use and occupation or rent to The Lehigh Coal and Navigation Company for the more profitable portion of the Debtor's lines located entirely in the State of Pennsylvania, thus resulting in the capitalization, in computing the franchise tax, of an expense necessary to profitable operation as if such expenses were income; and that other serious questions

exist as to the validity, legality and constitutionality of said Statutes as applied to Debtor.

14. Your petitioners are uncertain whether or not they should comply with and submit the Debtor's estate to the additional burdens, conditions, payments and agreements required by the provisions of Chapter 241 of the Pamphlet laws of New Jersey of 1942, in view of their earlier compliance with the provisions of Chapter 290 of the Pamphlet Laws of New Jersey of 1941 and in view of the provisions of Section 57j of the Federal Bankruptcy Act. Especially, they are uncertain whether to pay said retroactive franchise tax for 1941 of $239,749.80 and the additional interest required by said Chapter to be paid. Your petitioners allege that they should not be required to comply with said Chapter 241 unless or until this Court shall have adjudicated that the amount of the claim of the State of New Jersey against the Debtor for the years 1932 to 1939, both years inclusive, is the principal amount of taxes alleged to be due by the Debtor for said years, payable in the manner, at the times, with the interest, and upon the terms and conditions prescribed by said Chapter 241, and shall further have disallowed and dismissed the claim or claims of the State of New Jersey for interest or interest penalties on any of the aforesaid principal amount of taxes.

[fol. 415] 15. Your petitioners are informed and therefore allege that subsequent to the entry of Order No. 123 in this cause and subsequent to compliance by your petitioners with said Order and with Chapter 290 of the Pamphlet Laws of New Jersey of 1941 the Attorney General of the State of New Jersey filed a civil information and later an amended civil information in the Court of Chancery of New Jersey wherein and whereby he challenged the constitutionality of said Chapter 290. Your petitioners have recently been further informed and therefore allege that on May 21, 1942, the day on which Chapter 241 of the Pamphlet Laws of New Jersey of 1942 was approved, the Attorney General filed a supplemental civil information in said Court of Chancery challenging the constitutionality of said Chapter 241. Your petitioners show, however, that no final decision or decree by said Court of Chancery or by the Court of Errors and Appeals of the State of New Jersey touching the constitutionality of said laws can be

expected for many months, whereas your petitioners will be obliged to act, if they are to comply with said Chapter 241, on or before June 15, 1942. Your petitioners also show that this Honorable Court alone has jurisdiction to pass upon the claim of the State of New Jersey for interest penalties and that no future decision or decree of the Courts of the State of New Jersey can affect the allowability of such claim, or the finality of Order No. 123 and Order No. 135 in this cause.

Wherefore, your petitioners pray that they may have the protection of this Honorable Court in the premises and particularly the instructions of this Court whether or not they should comply with the provisions of Chapter 241 of the Pamphlet Laws of New Jersey of 1942; and that the Honorable David T. Wilentz, Attorney General of the State of New Jersey, the Honorable Homer C. Zink, Comptroller of the State of New Jersey, and the Honorable Robert C. Hendrickson, Treasurer of the State of New [fol. 416] Jersey, and all other parties to this proceeding, be required to show cause before this Honorable Court why the amount of the tax claim of the State of New Jersey against the Debtor for the years 1932 to 1939, both years inclusive, should not be fixed and adjudicated at the principal amount of taxes alleged to be due, payable in the manner, at the times, with the interest, and upon the terms and conditions prescribed by said Chapter 241, and why the interest or interest penalties as claimed by or on behalf of the State of New Jersey in this proceeding should not be disallowed.

And your petitioners will ever pray, etc.

Shelton Pitney, Walter P. Gardner, Trustees.

Dated: June 2, 1942.
Filed: June 2, 1942.

Verification dated June 2, 1942, omitted in printing.)

[fol. 417] IN THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF NEW JERSEY

In the Matter of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, Debtor

In Proceedings for the Reorganization of a Railroad

No. 29,778

Order No. 161 to Show Cause

Upon reading and filing the petition of the Trustees duly verified the second day of June, 1942 for instructions whether or not they should comply with Chapter 241 of the Pamphlet Laws of New Jersey of 1942 and for other relief,

It is on this second day of June, 1942 ordered that Monday, the 8th day of June, 1942 at 10:30 A. M. (E. W. T.) in the court rooms of this Court in the Post Office Building, Federal Square, Newark, N. J., be and the same is hereby fixed as the time and place for the hearing upon said petition.

And it is further ordered that the Honorable David T. Wilentz, Attorney General of the State of New Jersey, the Honorable Homer C. Zink, Comptroller of the State of New Jersey, and the Honorable Robert C. Hendrickson, Treasurer of the State of New Jersey, and all other parties to this cause, including all parties to whom notices of hear-[fol. 418] ings are customarily given, be required to show cause before this Court at the time and place aforesaid why the amount of the tax claim of the State of New Jersey against the Debtor for the years 1932 to 1939, both years inclusive, should not be fixed and adjudicated at the principal amount of taxes alleged to be due, payable in the manner, at the times, with the interest, and upon the terms and conditions prescribed by said Chapter 241, and why the interest or interest penalties as claimed by or on behalf of the State of New Jersey in these proceedings should not be disallowed and dismissed.

And it is further ordered that notice of the aforesaid hearing and of the return date of this order to show cause shall be given to the Honorable David T. Wilentz, Attorney General of the State of New Jersey, the Honorable Homer C. Zink, Comptroller of the State of New Jersey, and the Honorable Robert C. Hendrickson, Treasurer of the State

of New Jersey, and to each other party to these proceedings, including each party to whom notices of hearings herein are customarily given, by serving a copy of this order to show cause and a copy of said petition of the Trustees upon each such person and party, either personally or by leaving such copies at their respective offices with their respective clerks or other persons in charge thereof, within one day from the date of this order.

Guy L. Fake, United States District Judge.

Filed: June 2, 1942.

[fol. 419] IN THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF NEW JERSEY

In the Matter of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, Debtor

In Proceedings for the Reorganization of a Railroad

No. 29,778

Order No. 163 Adjudicating the Amounts in Which the Claims of the State of New Jersey Should Be Allowed and Directing the Trustees to Comply with Chapter 241 of the Laws of New Jersey of 1942 *

This matter coming on for hearing at the time and place fixed by Order No. 161 in this cause for the hearing upon the petition of the Trustees of the Debtor for instructions whether or not they should comply with Chapter 241 of the Laws of New Jersey of 1942 and for other relief; and the matter having been opened to the Court by Shelton Pitney, one of and on behalf of the Trustees, in the presence of the Honorable David T. Wilentz, Attorney General of the State of New Jersey, the Honorable Homer C. Zink, Comptroller of the State of New Jersey, and J. H. Thayer Martin, Esq., counsel for the Honorable Robert C. Hendrickson, Treasurer of the State of New Jersey, and in the presence of counsel for various other parties to this proceeding; and testimony having been adduced by and on

* The petition for and Order No. 162 relate to a different subject and are printed hereafter.

behalf of the Trustees in support of the allegations of their petition, and this Court having considered said testimony and the documentary evidence introduced, and [fol. 420] having heard and considered the arguments of said Messrs. Pitney, Wilentz, Zink and Martin,

The Court does hereby find and adjudicate the following facts:

(1) On or about December 10, 1940 the State of New Jersey, by its Comptroller, filed in this cause proof of claim No. 38, claiming that the Debtor owed to the State of New Jersey on account of unpaid taxes for the years 1932 to 1939, both inclusive, a total of $12,117,450.68, plus alleged interest thereon in the sum of $7,732,339.53, and additional interest thereon from December 1, 1940 to date of payment. At the same time the State of New Jersey, by its Comptroller, filed in this cause additional proofs of claim for unpaid taxes for said years against the several companies and in the several amounts as follows:

No. of Claim	*Name of Company*	*Principal Amount of Claim*	*Amount of Interest Claimed*
34	The Central Railroad Company of New Jersey, as lessee of The Ogden Mine Railroad Company	$5,220.69	$5,149.19
35	The Central Railroad Company of New Jersey, as joint operator of The New York and Long Branch Railroad Company	318,305.30	140,495.05
36	The Central Railroad Company of New Jersey, as lessee of The Dover and Rockaway Railroad Company	13,636.37*	9,302.82
37	The Central Railroad Company of New Jersey, as joint operator of Bay Shore Connecting Railroad Company	5,528.40	3,601.50

* This should be "13,636.27."

[fol. 421] All of the claims for interest were made with additional claims for 1% per month on the principal

amounts claimed from December 1, 1940 to date of payment.

(2) The Trustees of the Debtor objected to all of said claims upon various grounds, to which objections reference is hereby made for greater certainty.

(3) By order No. 93 made and entered in this cause on April 1, 1941, said Claims Nos. 34, 35, 36, 37 and 38 of the State of New Jersey were referred to Augustus C. Studer, Jr., Esq., as Special Master, together with all objections thereto, for hearing and report thereon in accordance with said Order. No report has been made by the Special Master on said claims or any of them and no hearing thereon has been held before him.

(4) A recent statute enacted by the Legislature of the State of New Jersey has rendered it impracticable and impossible for the Special Master within the time limit therein fixed, to hear and report upon said claims, and requires that this Court take prompt action in the premises.

(5) By order No. 123 made and entered in this cause on August 8, 1941 this Court adjudicated and fixed at $13,438,669.19 the aggregate principal amount of the unpaid taxes levied and assessed by the State of New Jersey against the Debtor or its estate for the years 1932 to 1940, both inclusive, and adjudicated and fixed at $15,185.44 the aggregate principal amount of the unpaid taxes levied and assessed by the State of New Jersey against the properties of The Dover and Rockaway Railroad Company for the years 1942* to 1940, both inclusive, and adjudicated and fixed at $5,776.23 the aggregate principal amount of the unpaid taxes levied and assessed by the State of [fol. 422] New Jersey against the properties of The Ogden Mine Railroad Company for the years 1932 to 1940, both inclusive. Said sums of $13,438,669.19, $15,185.44, and $5,776.23 included the aforesaid total principal amounts of taxes claimed by the State of New Jersey against the Debtor, The Dover and Rockaway Railroad Company and The Ogden Mine Railroad Company, respectively, for the years 1932 to 1939, both inclusive, plus the excess of the taxes levied and assessed against the estate of the Debtor or its Trustees, against said The Dover and Rockaway

* This should be "1932."

Railroad Company and against said The Ogden Mine Railroad Company for the year 1940 over the amount paid by the Trustees or caused to be paid by the Trustees on account thereof pursuant to the provisions of Order No. 72 made and entered in this cause on December 2, 1940.

(6) By said Order No. 123, this Court ordered the Trustees of the Debtor to settle, compromise and pay said aggregate principal amounts of $13,438,669.19, $15,185.44 and $5,776.23 of taxes claimed in accordance with and in acceptance of the provisions of the then recently enacted Chapter 290 of the Laws of New Jersey of 1941, and authorized the Trustees to execute and file or tender the certain undertakings and waivers required by said chapter together with all such other instruments as might be prescribed or required to comply therewith; and further authorized the Trustees to tender and pay the required first installment of one-twentieth of said aggregate principal amount of $13,438,669.19 and said entire sums of $15,185.44 and $5,776.23, together with interest on said principal amounts at the rate of 3% per annum from December 1, 1940 to the date of payment.

(7) The Trustees of the Debtor duly complied with said Order No. 123 and with said Chapter 290, and took all steps [fol. 423] necessary or possible on their part in that behalf, including payment or tender of payment to the Treasurer of the State of New Jersey of $951,872.83, representing the required first installment on account of said alleged State taxes relating to properties of the Debtor, plus interest at the rate of 3% per annum from December 1, 1940 to the date of said payment, on the aggregate principal amount of taxes alleged to be due, and by paying or tendering to the said Treasurer the full principal amounts of alleged State taxes of The Dover and Rockaway Railroad Company and of The Ogden Mine Railroad Company, together with interest computed in the manner prescribed by said Act. The Trustees of the Debtor further caused The New York and Long Branch Railroad Company and Bay Shore Connecting Railroad Company to take all steps necessary to comply with the provisions of said Chapter.

(8) Subsequently, by Order No. 135 made and entered in this cause on November 24, 1941, this Court adjudicated and decreed that the Trustees of the Debtor had taken all

steps necessary on behalf of the Debtor's estate and on behalf of its affiliated Companies, The Dover and Rockaway Railroad Company and The Ogden Mine Railroad Company, to comply with the provisions of said Chapter 290 of the Laws of New Jersey of 1941, and had joined in causing The New York and Long Branch Railroad Company and Bay Shore Connecting Railroad Company to take all steps necessary to comply with the provisions of said chapter.

(9) Said Order No. 135 also directed the Trustees on or before December 1, 1941 to pay in full the taxes assessed against the Debtor and its said affiliated companies by the State of New Jersey for the year 1941. Said taxes so ordered to be paid had been levied and assessed under and by virtue of Chapter 291 of the Laws of New Jersey [fol. 424] of 1941. No franchise tax was levied or assessed against or was payable by the Debtor or its Trustees in and for said year 1941 under or by virtue of said Chapter 291.

(10) The Trustees of the Debtor duly complied with said Order No. 135 and within the time thereby limited paid in full the taxes so levied and assessed against the Debtor and said affiliated companies by the State of New Jersey in and for the year 1941.

(11) By Chapter 169 of the Laws of New Jersey of 1942, approved May 8, 1942, the franchise tax provisions of said Chapter 291 of the Laws of 1941 were so amended as to make the Debtor or its Trustees assessable for a retroactive franchise tax for the year 1941. Acting under the authority of said 1942 amendment, the State Tax Commissioner of the State of New Jersey has now purported to levy and assess against the Debtor or its Trustees a retroactive franchise tax for the year 1941 amounting to $239,749.80.

(12) By Chapter 241 of the Laws of New Jersey of 1942, approved May 21, 1942, Chapter 290 of the Laws of 1941 was amended so as to provide that any railroad taxpayer desiring to accept the provisions of the Act must, on or before June 15, 1942, file with the State Treasurer a new and additional acceptance document and waiver in the form prescribed by the Act, providing for the payment in full of the principal amount of all unpaid taxes for the

years 1932 to 1940, both inclusive, at the times and in the manner provided by the Act, and waiving any and all rights to contest the legality or amount of any assessment on its property used for railroad purposes made prior to December 1, 1941, pursuant to the applicable tax Acts. The acceptance document so required must also waive any and all rights to contest the legality or amount of any assessment "heretofore or hereafter made for the tax year one thousand [fol. 425] nine hundred and forty-one". Said Act also requires such taxpayer to file with the State Treasurer an additional consent to the discontinuance and dismissal of any and all suits, actions and proceedings pending in any court or before the State Board of Tax Appeals respecting any such assessments and at the same time to pay to the State Treasurer the initial installment payment provided for by the Act, with interest as therein specified.

(13) The Trustees submitted in evidence at the hearing on the return of Order No. 161 a proposed form of "Acceptance and Waiver", a proposed "Discontinuance and Dismissal", and a proposed "Letter of Transmittal to the State Treasurer", in form sufficient to comply with said Chapter 241.

(14) Said Chapter 241 requires the taking of the various steps necessary to a compliance therewith and the making of the initial payment thereon on or before June 15, 1942 and further requires that said initial payment shall include interest at the rate of 3% per annum on the entire aggregate principal amount of taxes claimed from December 1, 1940 to the date of such first installment payment. Said requirement has the effect of adding substantially to the amount of interest required to be paid or tendered by the Trustees to the Treasurer of the State of New Jersey in excess of the amount paid or tendered by them pursuant to the 1941 law and as directed by said Order No. 123 of this Court, notwithstanding that the Trustees and the Debtor's estate have not since had the use of the moneys so paid or tendered.

(15) Said Chapter 241 of the Laws of New Jersey of 1942 also contains provisions penalizing any future defaults in the making of any payment provided for in the acceptance document in a manner more onerous than the penalties [fol. 426] provided for by said Chapter 290 of the Laws of 1941 in the event of a default in compliance therewith.

This Court does hereby Order, Adjudicate and Decree:

1. That it is essential to the reorganization of the Debtor's estate that the amount of the Debtor's major obligations be promptly fixed, determined and settled.

2. That, because Chapter 241 of the Laws of New Jersey of 1942 requires that said chapter must be accepted if at all, on or before June 15, 1942, it is necessary to the reorganization of the Debtor and to the orderly conduct of this cause that this Court at this time pass upon the fairness of the settlement offered by the State of New Jersey and the amounts for which the State's claims should be allowed, and to that end this Court does hereby revoke so much of Order No. 93 in this cause as referred claims Nos. 34, 35, 36, 37 and 38, together with all objections thereon, to the Special Master for hearing and report thereon.

3. That for the reasons set forth in the objections filed in this proceeding by the Trustees of the Debtor to each of said claims there is ground for serious doubt as to whether the full amount of taxes claimed is legally due.

4. That the Trustees of the Debtor should not be required to comply with Chapter 241 of the Laws of New Jersey of 1942 without a simultaneous order by this Court adjudicating the amounts for which the aforesaid claims of the State of New Jersey, for the years 1932 to 1939, inclusive, and the balances in dispute for 1940 should be allowed.

[fol. 427] 5. That, since a determination must be made prior to June 15, 1942, as to whether or not the Trustees should accept the provisions of Chapter 241 of the Laws of 1942, since, further, it is not possible for the Court in the short time available before that date to try the issues of fact raised by Claims Nos. 34 to 38 inclusive, and the objections filed thereto and determine accurately the amounts now legally due; and since the Court, as a matter of law, has concluded that the offer of settlement officially tendered by the claimant through the enactment of Chapter 241 is a valid and subsisting offer made to carry into effect a public policy set forth in said act, at least so far as a debtor railroad in reorganization under the Bankruptcy Act is concerned, the Court hereby adjudicates the amount for which said claims of the State of New Jersey against the

Debtor's estate (including the balances in dispute for 1940 *) should be and they are hereby allowed as follows:

Name of Company	*Amount of Claim Allowable*
The C.R.R. Co. of N.J., Lessee of The Ogden Mine R.R. Co.	$5,220.69
The C.R.R. of N.J., as Joint Operator of The New York & Long Branch R.R. Co.	318,305.30
The C.R.R. Co. of N.J., as Lessee of The Dover & Rockaway R.R. Co.	13,636.37†
The C.R.R. Co., of N.J. as Joint Operator of Bay Shore Connecting R.R. Co.	5,528.40
The C.R.R. Co. of N.J., Debtor	13,438,669.19

payable in the manner, at the times, with the interest and upon the terms and conditions prescribed by said Chapter 241.

[fol. 428] 6. The Trustees accordingly should be and they are hereby instructed and directed on or before June 15, 1942 to comply and on behalf of themselves and their successors to agree to comply in the future in all respects with said Chapter 241 and to make the payments therein required to be made—all in the manner, at the times, with the interest and upon the terms and conditions therein prescribed; and this Court hereby adjudges that upon full compliance as aforesaid Claims Nos. 34, 35, 36, 37 and 38 will have been fully satisfied and discharged.

7. That the obligations of the Trustees under each and all of the documents to be filed by them as above ordered shall be their obligations solely as Trustees of the property of the Debtor and not their individual obligations and that all obligations of the Trustees filed pursuant to this order and said Chapter 241 shall be assumed by The Central Railroad Company of New Jersey, or any other corporation, or any receiver or receivers or trustee or trustees, who may succeed the Trustees in possession of the property of the

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* In the case of the properties of the Debtor only (see finding 1 on page 2768).

† This should read "13,636.27."

Debtor's estate, whether pursuant to any plan of reorganization under Section 77 of the Bankruptcy Act, or otherwise. Nothing herein contained shall be construed as passing upon the validity or invalidity of Chapter 290 P.L. 1941 or Chapter 241 P.L. 1942 attacks upon which are now pending in the State Courts.

Guy L. Fake, United States District Judge.

Dated: June 12, 1942.
Filed: June 12, 1942.

[fol. 429] IN THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF NEW JERSEY

In the Matter of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, Debtor

In Proceedings for the Reorganization of a Railroad

No. 29,778

Petition of Trustee for Order for Instructions Regarding the Payment of Taxes to the State of New Jersey

To the Honorable Guy L. Fake, Judge of the United States District Court for the District of New Jersey.

The petition of Walter P. Gardner, Trustee of the property of the Debtor, respectfully shows that:

1. Your petitioner and Shelton Pitney were appointed Trustees of The Central Railroad Company of New Jersey by order of this court dated the 28th day of November, 1939, and duly qualified as such Trustees under said order. On January 13, 1946, Shelton Pitney died and since that date the properties of the debtor have been and now are being operated by your petitioner as sole surviving Trustee.

2. On October 30, 1939, the debtor filed its petition herein because the State of New Jersey had threatened to enter judgment and sell its properties located within [fol. 430] the State for nonpayment of 1932 and 1933 taxes, litigation concerning which had resulted unfavorably to the debtor.

3. In December, 1940, the State of New Jersey filed its claim No. 38, against the debtor, for $12,117,450.68 taxes, plus interest thereon in the sum of $7,732,339.53, plus additional interest on said unpaid taxes from December 1, 1940 to the date of payment, claiming said taxes to be a lien paramount to all other liens upon all of the lands and tangible property and franchises of the company in the State of New Jersey, in accordance with the provisions of Section 54:27-4, Revised Statutes of the State of New Jersey, such lien taking effect on June 1 of the year in which the tax is payable.

4. At the time the debtor filed its petition for reorganization, as aforesaid, practically all the railroads operating in New Jersey were in default in payment of their franchise and property taxes and a number like the debtor had filed their petitions for reorganization under the Bankruptcy Act. The Governor of the State taking cognizance of this situation appointed a committee to investigate the railroad tax problem. The Governor's committee on February 22, 1941, made a comprehensive report, which was subsequently considered by a committee of the Legislature, with the result that Chapters 290 and 291 were passed and approved and became effective on July 22, 1941. Chapter 290 is commonly known as the first Railroad Tax Settlement Act. Chapter 291, P.L. 1941, provided for taxes on both the franchises and properties of railroads doing business within the State of New Jersey.

5. By the provisions of Chapter 290 the State Treasurer was authorized and required to accept, without interest penalties, installment payments of the principal [fol. 431] amount of the taxes assessed and unpaid for the years 1932 to 1940 inclusive, provided the railroad taxpayer complied with Sections 7 and 8 of the said Act, the provisions of which were as follows:

> "7. Undertaking; first payment. Any railroad or system, or the receiver, trustee or trustees thereof, may enter upon the execution of an installment payment plan authorized under this act by (1) duly executing and filing with the State Comptroller a written undertaking, in such form as the Attorney-General shall prescribe, for the payment of the total amount of delinquent taxes owed by the railroad or

system and (2) paying into the State treasury an amount not less than the first annual installment together with interest on the unpaid balance computed in the manner provided by sections two, three and four of this act.

"8. Waivers. The first payment tendered pursuant to this act shall be accompanied by a waiver of any and all rights to contest the legality or amount of any assessment made prior to December first, one thousand nine hundred and forty-one, together with stipulations, consents or other papers for the discontinuance and dismissal of all suits, actions, and proceedings pending in any court or before the Board of Tax Appeals concerning such assessments, all in such form as the Attorney-General may require."

6. On August 8, 1941, the District Court upon application of the Trustees, having considered the statutory offer of settlement, authorized the Trustees of the debtor to accept the compromise of said tax claim by agreeing to pay the full unpaid balance of the principal amount of taxes assessed from 1932 to 1940 inclusive, viz., the principal of $13,438,669.19, said payments to be made in installments [fol. 432] over a period of twenty years, as authorized by said Act, without penalties but with interest at 3% per annum, computed from December 1, 1940, as required by the terms of the said Act.

7. The Trustees thereupon made the payments, filed with and delivered to the appropriate officer of the State, all documents including requests for discontinuance of pending appeals and a waiver of all right to contest the validity and amount of any assessment made prior to December 1, 1941, as required for full compliance by them and subsidiary companies with the conditions of the offer of settlement and the order of the Court.

8. After all this had been done, and on September 4, 1941, the Attorney General, David T. Wilentz, instituted a proceeding in the Court of Chancery of New Jersey against the State Treasurer, attacking the constitutionality of Chapter 290. Neither the Debtor nor the Trustee nor in fact any railroad was a party to this suit in the Court of Chancery.

9. While the suit instituted by the Attorney General against the State Treasurer (Wilentz *v.* Hendrickson) hereinbefore mentioned, was still pending and undetermined, the Legislature enacted Chapter 169, P.L. 1942, which became effective May 8, 1942, amending certain provisions of Chapter 291, P.L. 1941 so as to levy a retroactive franchise tax against the debtor for the preceding year 1941 in the additional amount of $239,749.80. Said law also operated to reduce the franchise taxes assessed for 1941 against most of the other railroads operating in New Jersey and completely to eliminate from franchise taxes certain other railroads operating in New Jersey. Your petitioner believed at that time and still believes that said chapter arbitrarily and unjustly discriminated as between railroad taxpayers subject to the [fol. 433] Railroad Tax Act of the State and resulted in singling out the debtor as a victim of an arbitrary recomputation of the 1941 franchise taxes while at the same time financially benefiting other railroad taxpayers.

10. Thereafter the Legislature of New Jersey enacted Chapter 241, P. L. 1942, approved and effective May 21, 1942, amending in various respects Chapter 290, P. L. 1941, (the Tax Settlement Act). Chapter 241 added various burdens and conditions to those imposed upon the debtor by the Act which it amended. Among other things it provided that:

> "taxpayer desiring to accept the provisions of this act shall, on or before June 15th nineteen hundred and forty-two, file with the State Treasurer the acceptance document required by this act . . . waiving any and all rights to contest the legality or amount of any assessment on its property used for railroad purposes made prior to December 1st, nineteen hundred and forty-one, pursuant to the applicable tax acts and of any assessment heretofore or hereafter made for the tax year nineteen hundred and forty-one. . . ."

11. To accept the benefit of the 1942 Tax Settlement Act the Trustees were required unequivocally to abandon their challenge of the retroactive franchise tax for 1941 in the amount of $239,748.80, and to incorporate in their "Acceptance Document" their written waiver of "any

and all rights to contest the legality or amount" of said retroactive franchise tax assessment, and also any other tax that might thereafter be assessed for said year, or risk the contention that they had abandoned their acceptance of the State's offer or had failed in any respect to comply therewith in good faith. The Trustees were also required by Chapter 241 to make an additional interest payment on or before June 15, 1942 in an amount exceeding [fol. 434] $340,000., which resulted from the requirement of accelerated payment of interest and the requirement that interest be computed from December 1, 1940 upon the entire principal amount of taxes claimed by the State as of that date, without deducting therefrom the first installment of principal previously tendered in the form of a certified check which was then and still is in the custody of the State Treasurer. The Trustees had only between May 21, 1942 and June 15, 1942 to secure court approval of the acceptance of the settlement contained in Chapter 241, P. L. 1942, and to comply therewith. This approval was obtained, and the Act was fully complied with by the Trustees.

12. The same day that said Chapter 241, P. L. 1942, was approved by the Governor, the Court of Chancery granted an order to show cause with an ad interim restraint restraining the State Treasurer from carrying out or executing any of its provisions.

13. After the Trustees had complied and had caused their four affiliated companies to comply with Chapter 241, P. L. 1942, and had in good faith and in accordance with the terms of the order of the District Court Waived all their rights of contest as to taxes assessed prior to December 1, 1941 and had paid without contest the retroactive franchise tax of $239,748.80 and the additional and accelerated interest, hereinbefore mentioned, the Court of Chancery on September 8, 1943, entered its final decree in the case of Wilentz *v.* Hendrickson, 133 N. J. Eq. 447. In his opinion in that case the Vice Chancellor held the Railroad Tax Settlement Acts were unconstitutional, being violative of Article I, Paragraph 20 of the State Constitution, which provides:

> "No donation of land or appropriation of money shall be made by the State or any municipal corpora-

[fol. 435] tion, to or for the use of any society, association or corporation whatever."

14. The State Treasurer appealed the decision of the Court of Chancery against him to the New Jersey Court of Errors and Appeals which on June 22, 1944, filed its opinion affirming the decree of the Court of Chancery on the ground that the remission, cancellation and abatement of the delinquent interest was not supported by a legal, equitable or moral consideration.

15. The order of the District Court which directed the Trustees of the debtor to comply with the provisions of Chapter 241, P. L. 1942, on or before June 15, 1942, also fixed and determined the amount of the State's claim for taxes. The Attorney General of the State appealed from this order to the United States Circuit Court of Appeals and that court reversed so much of the order as determined the amount of taxes due the State of New Jersey but the court said:

> "One final point must be noticed. Order No. 163 authorized the trustees of the debtor to comply with the Tax Settlement Acts by executing and filing the documents and making the payments therein re-quired. Since the law directed that these steps be taken on or before June 15, 1942, it is vitally important to the debtor, in case the constitutionality of the Tax Settlement Acts is ultimately sustained, that the tenders made by the trustees prior to that date, pursuant to the directions of Order No. 163, be not invalidated by the reversal of that order. Accordingly so much of paragraphs 6 and 7 of Order No. 163 as authorizes the trustees to comply with the requirements of the Tax Settlement Acts will not be disturbed."

[fol. 436] 16. The cause was remanded "with directions to the District Court to wait the determination by the Court of Chancery of the State of New Jersey of the constitutionality of the Railroad Tax Settlement Acts, unless it finds that delay which may be harmful to the debtor and its creditors may result, in which event it may proceed itself to hear and decide the constitutional issue."

17. The Trustees filed their petition to the Supreme Court of the United States for writ of certiorari to review

the decision of the United States Circuit Court of Appeals but the Supreme Court denied certiorari.

18. Within two months after the decision of the Court of Errors and Appeals in Wilentz *v.* Hendrickson, to wit, and on or about August 12, 1944, the Trustees filed with the District Court their petition entitled "Petition for Adjudication Concerning New Jersey State Tax Claims." In said petition they raised, among other questions, (1) whether there had been a valid contract of settlement between the Trustees and the State of New Jersey, (2) the nature and extent of the State's lien, if any, against the properties of the debtor, (3) what interest or penalties if any had accrued on the State's taxes since the petition herein was filed, all of which questions your petitioner alleges are within the sole jurisdiction of the Bankruptcy Court and are questions which the Bankruptcy Court must decide. Upon being served with the petition for adjudication of the trustees, the Attorney General on behalf of the State filed a special appearance and objected to the petition being entertained by the court on the ground that it constituted the prosecution of a suit, claim or demand against the State, and moved to dismiss the petition insofar as it prayed for an adjudication or determination that the claims for taxes are less than the sums assessed against the debtor, and insofar as the liens of the State for such [fol. 437] taxes and interest are sought in any wise to be altered, affected, modified or destroyed by any such adjudication or determination. Upon the filing of the said special appearance of the Attorney General and after a hearing held October 16, 1944, this court, on motion of the Trustees, made its Order No. 250

> "That all tax claims filed by the State of New Jersey, the Trustees' objections thereto and the State's reply to said objections, and also the aforesaid purported special appearance of the State objecting to the jurisdiction of this court filed herein on August 28, 1944 be and the same are hereby referred and re-referred to Augustus C. Studer, Jr., Esq., as Special Master, for hearing and report thereon."

The Special Master on January 17, 1945, filed an interim report in which he reported that in his opinion the Bankruptcy Court is the proper court to determine the validity

and amount of the tax claims of the State and the incidential liens alleged to affect the property in the custody of the court. He concluded with the statement:

> "It is the opinion of the Master that the claim of the State to sovereign immunity should be denied and that the petition of the Trustees should not be dismissed."

Objections were duly made to the said interim report by the Attorney General and from Order No. 271, dated March 5, 1945, overruling the objections of the State to the interim report of the Special Master the Attorney General appealed to the United States Circuit Court of Appeals. The United States Circuit Court of Appeals on November 15, 1945, decided that Order No. 271 of the District Court should be reversed and held that

> "the only matters left open for the Bankruptcy Court to pass upon are (1) Mathematical error in the com- [fol. 438] putation of the amount of the tax, or (2) Legal error in its assessment • • •".

On March 19, 1946, petitioner filed his petition for rehearing. Said application for rehearing was denied on March 29, 1946.

19. Your petitioner's counsel at the present time is engaged in the preparation of a petition to the Supreme Court of the United States for a writ of certiorari to review the decision of the United States Circuit Court of Appeals filed November 15, 1945, as aforesaid. It is expected that said petition will be filed before April 22, 1946, and your petitioner is hopeful that the Supreme Court will act on his petition for such writ before the adjournment of the Court in June.

20. Since the decision of the United States Circuit Court of Appeals on November 15, 1945 the Attorney General of the State of New Jersey has urged your petitioner as Trustee and the bondholders committees represented in the proceeding to pay a substantial part of the taxes alleged by the State of New Jersey to be due it under its said claim. At a conference between your petitioner and his counsel and the Institutional Group Bondholders' Committee and their counsel it has been decided that your peti-

tioner should apply to the District Court for instructions as to whether he should at this time pay an amount approximately equal to the principal amount claimed by the State of New Jersey in its said proof of claim for the years 1932 to 1939, inclusive, to wit, $12,117,450.68, plus the sum of $1,321,218.51 being an amount approximately equal to the principal amount of unpaid taxes claimed by the State for the year 1940 or a total sum of $13,438,669.19, or such other sum as the Court may direct, it being the opinion of all of the parties, including your petitioner, that such amount should now be paid to the State as will approxi-
[fol. 439] mate the total amount that is due to the State if the Settlement Acts are ultimately held to be valid as to the Debtor's Estate.

21. Your petitioner calls attention to the fact that in the effort to strictly comply with the conditions specified in the Tax Settlement Acts, the Trustees paid or tendered to the appropriate State officer in the form of certified checks on the dates shown in Exhibit "A" attached hereto the several amounts specified in said exhibit.

22. Your petitioner has sufficient funds in hand at the present time with which to make the payment proposed in paragraph 20, in the event that the court orders the same. Your petitioner, however, is informed and verily believes that the moneys which he has in hand at the present time out of which taxes would have to be paid are moneys derived largely, if not entirely, from assets and earnings to which the State's lien does not extend.

23. Your petitioner desires to point out that in the event that the Supreme Court of the United States should allow your petitioner a writ of certiorari and should later decide that there is a valid and existing contract between him and the State of New Jersey, your petitioner by making the payment specified in paragraph 20 hereof would lose one of the benefits of such contract, viz., the privilege of making payment in installments over a period of years.

Your petitioner therefore prays that an order may be made instructing him whether he should at this time pay out of the funds in his hands to the State of New Jersey the sum of $13,438,669.19 or some other sum in such way and manner as will protect the debtor's estate and stop the
[fol. 440] further running of penalties and interest on the

amount so ordered paid, and that he may have such other and further relief as in the premises may seem equitable and just.

Walter P. Gardner, Trustee, Petitioner.

(Verification dated April 15, 1946, omitted in printing.

[fol. 441] EXHIBIT A

Tax Tenders to the State of New Jersey by Trustees of The Central Railroad Company of New Jersey

Date of Tender	Amount of Tender	Division between Principal and Interest if Applied Under Settlement Acts		Checks Retained By State
		Principal	Interest	
August 11, 1941	$ 951,872.83	$ 671,933.46	$ 279,939.37	Yes
June 15, 1942	590,816.69	250,000.00	340,816.69	Yes
December 1, 1942	1,000,000.00	825,758.75	174,241.25	Yes
December 1, 1943	1,035,000.00	680,489.42	354,510.58	Yes
December 1, 1944	1,015,000.00	680,885.07	334,114.93	No
January 2, 1945	3,079,184.94	3,051,683.49	27,501.45	No
December 1, 1945	900,000.00	701,035.66	198,964.34	No
Total	$8,571,874.46	$6,861,785.85	$1,710,088.61	

The separations shown above between principal and interest are not specified in the Court orders, authorizing these payments, nor were they set forth at the time the payments were made, but merely represent our calculations as to how these payments apply.

All of these payments except the payment on January 2, 1945, were tendered solely under the provisions of the Settlement Acts. The January 2, 1945, payment was tendered under the provisions of the Settlement Acts, with the alternative condition that, if the Settlement Acts should ultimately be held invalid as to the Central Railroad of New Jersey, these payments would then be applicable to the principal amount of taxes due for the years 1932 and 1933.

April 13, 1946.

[fol. 442] IN THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF NEW JERSEY

In the Matter of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, Debtor

In Proceedings for the Reorganization of a Railroad

No. 29,778

Order No. 333 Authorizing and Directing Trustee to Make Payment on Account of Taxes Claimed by State of New Jersey

This cause coming on to be heard pursuant to order entered herein on April 16, 1946, and it appearing to the

Court that due notice of said order and of the hearing thereon has been served as said order directed and the Court having reviewed the record and having heard the parties and being fully advised in the premises, it is

Ordered, Adjudged and Decreed:

1. The Trustee is hereby authorized and directed to pay to the State of New Jersey within 10 days the sum of $15,250,000.00 in cash on account of tax claims of the State of New Jersey for the years 1932 to 1940, inclusive, including interest thereon, if any, said payment to be made upon the following conditions, to which the State of New Jersey, by acceptance of said payment, shall be deemed to have expressly assented:

(a) in the event that the claims of the State of New Jersey shall be finally determined to be an amount [fol. 443] greater than said payment, said payment shall be deemed to have been applied in satisfaction of said claims, as finally determined, for each of the years commencing with 1940 and extending back through each of the preceding years and portion thereof that said payment shall be sufficient therefor, *provided* that with respect to any year for which such payment shall be sufficient to satisfy only a portion of the claim the application shall be deemed to have been made ratably as between the principal amount of the tax and the interest thereon, at the rate finally determined, computed to the date of said payment; and provided further, that if it shall be finally determined that this Court may direct the application of said payment solely to the satisfaction of the principal amount of said claims, the application of said payment shall be deemed to have been made solely in satisfaction of said principal amount;

(b) in the event that the claims of the State of New Jersey shall be finally determined to be an amount less than said payment, the amount of such overpayment shall be credited by the Treasurer of the State of New Jersey upon the taxes next legally levied and payable to the State of New Jersey, subsequent to such determination, by the Trustee or the Debtor or any successor in title to substantially all of the properties of the Debtor located in the State of New Jersey;

(c) in making said payment the Trustee may, in his discretion, use the funds represented by certified checks in the aggregate amount of $3,577,689.52 payable to the Treasurer of the State of New Jersey, and tendered to said Treasurer pursuant to Orders Nos. 123, 163, [fol. 444] 178 and 216 entered herein, and for that purpose may regain possession of and surrender said checks for cancellation, without prejudice to effectiveness of said tenders or any other tenders or the legal consequences that may be found to have ensued therefrom.

2. Except as otherwise provided in paragraph 1 of this order, the making of said payment by the Trustee and the acceptance thereof by the State of New Jersey shall be without prejudice to the rights of or the positions asserted by either of them or any party hereto in litigation now or hereafter pending relating to said claims of the State of New Jersey. Guy L. Fake, United States District Judge.

Dated: April 26th, 1946.

The making and entry of the foregoing order is hereby approved.

Walter D. VanRiper, Attorney General of New Jersey, by Benj. C. Van Tine, Deputy Attorney General.

[fol. 445] IN THE DISTRICT COURT OF THE UNITED STATES FOR THE DISTRICT OF NEW JERSEY

In the Matter of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, Debtor

Bank 29,778

Hearing on Petition of Trustee for Order 333 Giving Instructions Regarding Payment of Taxes to State of New Jersey Newark, N. J., April 26, 1946.

Before: Hon. Guy L. Fake, U. S. D. J.

APPEARANCES:

Walter P. Gardner, Trustee.

James D. Carpenter, Jr., Attorney for Trustee, and Samuel M. Coombs, Jr., representing Trustee.

Alexander H. Elder, General Solicitor of The Central Railroad Company of New Jersey, representing The Central Railroad Company of New Jersey.

Walter D. Van Riper, Attorney General of the State of New Jersey, and B. C. Van Tine, appearing specially, representing the State of New Jersey.

[fol. 446] Charles Hershenstein and Milton B. Conford, appearing specially, representing the City of Jersey City.

Rathbone, Perry, Kelley and Drye, by Frank H. Heiss, representing Central Hanover Bank and Trust Company, mortgage trustee.

Fred N. Oliver, Blair Reilly, Willard P. Scott, and Joseph W. Kenna, representing Institutional Group of Bondholders.

Russell M. Van Kirk, pro se.

Mr. Carpenter: If your Honor please, I would like at this time to file proofs of publication of the order to show cause made by your Honor and proof of mailing of that order to show cause.

The Court: They will be marked in evidence.

(Exhibits T-1 and T-2 marked in evidence.)

Mr. Carpenter: If your Honor please, this is the return day of an order to show cause why the Trustee, Judge Gardner, should not be instructed whether to make a payment to the State on account of taxes, and if so what amount of taxes.

The facts are pretty well contained in the petition of the Trustee that was mailed to all of the creditors who have appeared in the proceeding, the bondholders' committees, to the State and to the principal stockholders; at any rate those who have appeared in the proceeding, as well as to the corporate trustee. The corporate trustee has filed an answer, as have the bondholders' committees.

I understand the corporate trustee wishes to introduce some evidence and I think this is perhaps the appropriate time for that to be done.

Mr. Van Tine: If your Honor please, before we get [fol. 447] under way may I have it noted on the record that in as much as the jurisdictional question is still pending now before the United States Supreme Court, that the State is here appearing specially, without waiving its rights under its jurisdictional question.

Mr. Carpenter: I wish to state that the State has no right to appear in this proceeding to enter a special appearance, if it is in the proceeding it is in generally.

It was in generally many different times in these proceedings, and being a claimant in these proceedings, with a claim on file, it cannot appear specially.

The Court: I will allow them to appear, reserving the question you raise until a later time.

Mr. Carpenter: There is one other thing I should advise the Court that is not set forth in the petition, and that is the petition recites that the Trustee was preparing a petition for a writ of certiorari to the Supreme Court. I should advise the Court that last Saturday that petition was filed with the Clerk of the Supreme Court and on Monday it was served on the Attorney General.

Mr. Van Tine: May I just reply to Mr. Carpenter and state that any so-called general appearance in the past was without authority and under the decisions of the Ford Motor Car Company against the Indiana Treasury Department, which was decided, I think, just about a year ago, even when the jurisdictional matter or objection has been raised before the United States Supreme Court for the first time, that is soon enough and we stand on that jurisdictional objection.

Mr. Heiss: Your Honor, before I call my witness to introduce some evidence I would like to state briefly the nature of the answer which has been filed by the Mortgage Trustee and the nature of the evidence which I plan to introduce.

It appears to us that a rather serious question is raised with respect to the rights of the bondholders under the General Mortgage of the Debtor by the application which [fol. 448] has been filed by the Debtor's Trustee in that the funds from which this tax payment, or payment of taxes, will be made consist of funds upon which the Debtor's General Mortgage constitutes a first and only lien, and that those funds are not subject to any lien of the State to secure the taxes in question, which are taxes which accrued prior to the institution of the bankruptcy proceedings.

We believe that to be the case not only because the statutes of the State of New Jersey as they existed at the date of the institution of this proceeding did not purport to impose any lien upon income or revenues of

the Debtor but only upon the tangible property of the Debtor in the State, but also because even if the amendment of the State statute which as enacted in 1941 which purported to impose retroactively a lien upon revenues as security for past due taxes, even if that statute is effective, which I doubt, an allocation of revenues and expenses as between the property of the Debtor in New Jersey and the properties of the Debtor outside of New Jersey will show that there have been no net revenues from the operations of the property in New Jersey, or almost none, that all, or the greater part of the revenues, and that all, or the greater part of the cash on hand have arisen from the operation of the Pennsylvania portion of the properties.

That being so any cash which is paid out, or which is available for being paid out at this time, is bondholders' cash that is held by the Trustee for the account of the bondholders, subject to such necessary expenditures as may be required in order to maintain the service of the road.

The only reason which would justify the paying of those monies not to the bondholders but to some other party would be that it would be in the interest of the bondholders to do so, that is, it would be in the interest of the bondholders to use this cash fund to redeem the [fol. 449] New Jersey properties from the lien which the State alleges that it has upon those properties.

Now, in the answer which we have filed we have brought those facts to the attention of the Court, in spite of the fact that the bondholders' committees represented here all favor this proposed tax payment. We believe it was our duty to bring these matters to the attention of the Court and call the Court's attention to the fact that before making the payment it must consider whether it is in the interest of the bondholders to take cash funds otherwise available for them and use them to redeem the Jersey properties.

Now I would like to call Mr. Wyer.

WILLIAM WYER, being duly sworn, testified as follows:

Direct examination.

By Mr. Heiss:

Q. What is your position with the debtor company, Mr. Wyer?

A. I am the Chief Executive Officer.

Q. And how long have you occupied that position?

A. Since July first, 1943.

Q. And as such are you familiar with the operations of the Debtor?

A. I think so.

Q. Have you, prior to your association with the Debtor, Mr. Wyer, had experience in relation to problems of the determination of the earning power or the segregation of the income and expenses of railroads in process of reorganization as between different parts or divisions of the railroad lines?

A. Yes, I have had a great deal of experience of that type. I have made such studies myself, or under my immediate supervision, and when I say that, I mean that the studies were made by a staff of my own firm, on the Seaboard Airline, the Denver and Rio Grande Western, the Central of Georgia, Florida East Coast, and I have been—[fol. 450] I should add to that the Alton Railroad—and I have been very closely in touch with and have examined in great detail and analyzed similar studies made on the New Haven, Erie, The Missouri Pacific and some others; and I also made such a study on the Central Railroad of New Jersey.

Q. Would you explain just very briefly and generally what the nature of such a study is?

Mr. Van Tine: If your Honor please, may I object to the materiality of these questions unless they are limited to the one question of whether or not you should at this time permit the payment of money. In other words, if there is an intent to create an issue on facts outside of the present petition, that is, in the present prayer, which is to permit the payment of money, then I shall object to it as being improper and not within the purview.

Mr. Heiss: I will be very happy to agree to such a stipulation.

Mr. Carpenter: If your Honor please, this is a trustee's prayer for instructions and I think it is for the trustee, within his rights, to advise the Court of all facts.

The Court: I can't tell what the witness is about to testify to and therefore cannot pass on any objection now.

Proceed.

Mr. Van Tine: Could we stipulate that the limit for which any of this testimony is to be used is for the purpose of helping you to determine whether at the particular time you should pay any amount of money to the State of New Jersey and for no other purpose?

The Court: That is correct isn't it?

Mr. Heiss: I think that is quite clear; from the purpose of the hearing nobody would consider it otherwise.

[fols. 451-480] The Court: Yes.

Mr. Van Tine: It is so stipulated?

Mr. Heiss: I will so stipulate.

* * * * * * *

[fols. 481-488] My last exhibit, CH-10, is headed "Elements of Value of the Physical Property of The Central Railroad Company of New Jersey Based upon Interstate Commerce Commission Calculations," and are shown there, the basis of these figures.

These are sometimes incorrectly referred to as Interstate Commerce Commission valuations. The Interstate Commerce Commission does not keep its valuation, as such, up to date. These are more properly described as elements of value and they are arrived at on the basis shown here.

On this basis the fixed property in New Jersey is valued at $123,248,161 and the equipment, allocatable to New Jersey, at $36,093,044, or a total of a little over $159,000,000.

Then the property owned and leased in Pennsylvania, including equipment owned and equipment leased by the Central Railroad of Pennsylvania, has a value on this basis of over $52,000,000.

And the property in New York owned and leased, mostly owned, including equipment, a value on this basis of a little over $5,000,000.

I think that concludes my discussion of these exhibits.

Mr. Heiss: I have no further questions of the witness, your Honor.

Mr. Oliver: Before you cross examine may I ask Mr. Wyer a question for information? This is not cross.

. . . . . .

[fol. 489] Mr. Carpenter: If your Honor please, I would like to state what the position of the Trustee is. The Trustee, of course desires to reduce in every proper way the [fol. 490] running of interest and penalties against this estate. He is prosecuting a petition to the Supreme Court for a determination which he has never been able to get secured, whether or not this road owes to the State of New Jersey the principal of its taxes payable on the line or whether they are payable over a period of years in accordance with the Settlement Acts of '41 and '42. There has never been a determination whether this estate is liable for interest as fixed by the tax settlement acts at three per cent or whether it is liable for this penalty of 12 per cent or one per cent per month. The State contends that is interest; the Trustee contends it is principal. Now, that question will have to be decided.

The Court: The Trustee contends it is penalty.

Mr. Carpenter: Yes—or a penalty, yes. The State contends it is interest. Now, that question has to be determined.

If it is determined under state law it is 12 per cent per annum, beyond any doubt it is reflected in Wilentz against Hendrickson and Jersey City against Van Riper.

If that is restricted by a law it may very well be that if the Settlement Acts are held unconstitutional by the Federal system the Court may say because of the long period of time it has been in litigation it would be inequitable for the estate to pay three or some other per cent of interest.

Now, the bondholders, after all, are most interested in this situation. The Trustee wants to perform his duties looking at the interest of all parties. He has asked for instructions of the Court. Now, the bondholders are represented here, there are representatives here of some stockholders and I think your Honor should listen to them and all we ask is that such an order you make preserve the [fol. 491] rights of the Trustee to have determined in this litigation now pending by the Federal Court how this money, whatever it is, shall be applied, whether it shall be applied to the payment of principal or partly to the payment of principal and partly in payment of the interest.

I suggest for your Honor's consideration that you determine whether or not in making this order that you feel bound to make that application in accordance with a decision of Judge Oliphant's in the State court, when you don't determine this claim being filed here money being paid out of the funds in the control of this court on this court's authority, you shouldn't determine how it should be paid and how it shall be applied.

Mr. Oliver: If your Honor please, may I suggest that it might be helpful to all of us to hear anyone who is opposed to the payment so we will know what argument is to be met.

The Court: Does anyone oppose?

Mr. Van Kirk: I would like to be heard, your Honor.

My name is Russell M. Van Kirk and I own personally a very substantial amount of Jersey Central 5 per cent bonds.

The Court: What is the amount?

Mr. Van Kirk: $740,000, and I represent about $2,100,000 of friends of mine who own bonds like I do.

I have listened with a great deal of interest this morning to Mr. Wyer's testimony and it is my opinion that inasmuch as the Court is looking after the interests of the Debtor, before the Court rules as to how much money shall be paid to the State of New Jersey in taxes and interest that the bondholders be given the right to vote as to whether or not [fol. 492] they wish to be relieved of the burden of the New Jersey properties.

In other words, your Honor, I think that a vote of the bondholders who, after all, are the creditors of this company, would determine adversely the fact that they do not wish to continue the New Jersey properties. In other words, the State of New Jersey is taxing us, along with penalties, a total amount of some $31,000,000.

Now, inasmuch as the railroad for the past ten years, even during a war period at which time railroads made good money, the properties in the State of New Jersey were operated at a loss with the exception of two years. The sum of twenty-six million odd dollars cash that the Central has today has been derived from earnings of properties outside of the State of New Jersey and that is money which the bank trustee will testify actually belongs to the bondholders.

Now, the question for the Court to decide is: are the properties in the State of New Jersey worth $31,000,000? If they are not then the Court, in my humble opinion, should not penalize the bondholders by paying out thirteen million or twenty million, or whatever amount the Court decides should be paid.

In other words, your Honor, I feel that before you do anything that the bondholders, who are creditors, should have the right to vote as to whether or not they wish to retain the New Jersey properties, and if they do then I am agreeable for one to pay whatever amount the railroad can legitimately pay.

But I think it would be a grave mistake today for you to decide to pay out any amount of money until the decision is reached as to whether or not the Jersey properties are worth any amount like $31,000,000.

[fol. 493] In addition, your Honor, Mr. Carpenter, the Trustee's attorney, is about ready, I believe, to present to the United States Supreme Court a petition for a writ of certiorari which, if it is acted favorably upon, the railroad and the debtor will be in a much better position than they are at the moment.

I respectfully suggest that you make no decision until Mr. Carpenter's petition has had a reasonable time to be heard.

Thank you very much.

The Court: Is there anyone else in opposition?

(No response.)

The Court: Apparently not.

Mr. Conford: If the Court please, I am not in opposition and I don't think the Attorney General is, but I would like to be heard on the form of the order and I think the Attorney General would.

The Court: Yes, I will hear you on the form of the order.

Mr. Van Tine: I would like to urge upon the Court the payment of the money and explain why when I have an opportunity.

The Court: I will give you that opportunity now.

Mr. Van Tine: If your Honor pleases, I came in this case just about a year and eight months ago. I think in the very first conference I had with you in the early part of September, 1944, I urged upon you the urgency of this matter.

The Court: Just let me correct you. I urged it first.

Mr. Van Tine: I believe, if your Honor pleases, you did call a conference.

The Court: And the conference was for the purpose of making a payment, if the Court could, to avoid penalty.

[fol. 494] Mr. Van Tine: That is correct.

Now, in that time, if the State of New Jersey is correct, there has accrued against this estate an additional $2,500,000 in interest.

Now, let's forget the word "penalty". You can't get around the fact that our Act says "interest". It has always said "interest". There is another provision for penalty in our Act and it comes squarely within the rule of the Amoli case, which was presented to your Honor even before I came into this case.

Now let's take the history of this case. In 1932 and 1933 this taxpayer, this debtor, defaulted on its taxes to the State of New Jersey. There was litigation in the New Jersey courts resulting in what is the modern rule laid down in the Central Railroad case reported in 114 New Jersey Law at page 69.

Now, they were not content with going through our courts and into the United States Supreme Court, as they had done with the 1931 tax, wherein the United States Supreme Court had refused certiorari, but instead they went this time to Judge Forman for an injunction and ultimately the United States Circuit Court of Appeals said the whole matter had been made res judicata by the Central Railroad case I mentioned before in 114 New Jersey Law. And the United States Supreme Court again refused certiorari.

Now, according to that petition and according to the petition just filed with the United States Supreme Court for certiorari in the latest McLaughlin opinion, they state that the reason they went into bankruptcy was because of this tax that the State of New Jersey was now seeking to enforce by the statutory proceeding.

[fol. 495] It is inconceivable to me how anyone could have, with the power now to issue receiver certificates and with no more litigation pending, with the United States Supreme Court having refused to review the matter of the validity of these assessments, that they should not have immediately paid with receiver certificates, which your Honor knows at that time could have been issued for less than two per cent, but instead with a studied stubbornness and an

obstinacy, a blind obstinacy, that is unparalleled in the history of any proceedings in this court, they refused to pay.

There was no possibility that they could go anywhere else and say that these taxes were less. And yet they allowed this money to accumulate, or allowed this interest to accumulate. Maybe for the next 12 months there was some reason why they should, although on the theory of res judicata I don't see how. But the fact was that for the '34, '35 and '36 cases Judge Forman had granted an injunction and that was pending.

Maybe they thought that not only would a miracle happen with reference to '34, '35 and '36 but maybe it would be retroactive. Maybe there was some reason.

But in 1940 the United States Circuit Court of Appeals said that this whole matter of the '34, '35 and '36 taxes had been made res judicata by the determination in the 1933 tax case. And your Honor did not in that case, in 1940, allow them to go to the United States Supreme Court. As a matter of fact, both your Honor and Judge Clark in the Susquehanna receivership said that you would not permit it. Judge Clark said, "I insist upon a proscription of futility."

Now, there is no doubt that in 1940 they should have gone out again but instead they allow this interest to accumulate [fol. 496] at 12 per cent a year instead of borrowing on receivership certificates at one or two per cent. They can't say they knew about any Settlement Acts because the Settlement acts weren't passed until July 22nd, 1941. Maybe they had hopes. Maybe hope does spring eternal in the human soul. However, these were trustees charged with responsibility not only to this debtor but to the State of New Jersey. And I say to your Honor with due deference and humility that when these people held from our taxpayers this money—or from our taxing authorities this money through all this period they did a grave injustice to the State of New Jersey and under the rule laid down in Boteler against Ingels reported by the United States Supreme Court in a Chicago and Northwestern case, the case out in the Seventh Circuit, a reorganization case, and the Davey case, there is no doubt that it is the trustees' charge and it is their responsibility to pay every penny of interest that is accumulated and accrued since the 30th day of October, 1939. There is no doubt about it.

Fiat justitia, ruat caelum; there is no doubt about it.

We are here in a court of equity and the spectacle of this court holding us at arm's length denying us the right to use our money and at the same time to say, "It isn't yours, Mr. State of New Jersey, it belongs to somebody else," is a principle that will never be established in a court of equity.

So I say to your Honor that there has been in this case an awful lot of complaint against the State of New Jersey which is unjustified. Every bit of the responsibility in this case must be placed directly in the hands or at the feet [fol. 497] of the trustees and their counsel who have been in charge of this reorganization.

Now, if your Honor pleases, there is no doubt that on the record here there is available for payment to the State of New Jersey $1,670,000, approximately $1,700,000, if we use the checks that are present in the State of New Jersey—held by an individual in the Treasurer's Office in Trenton.

Now, if your Honor pleases, you will remember that I have told you from the very beginning that we should stop the running of interest in this case and it could be done by a payment of any particular year, and forgetting if you will the Oliphant rule, the Erie rule, there never has been any law in the State of New Jersey which does not permit the railroad taxpayer to have picked out any one of those years.

The only time that the Oliphant formula and rule applies, if you want to pay less than the whole tax debt of a particular year.

Now, I offer to take from this court any amount of money that the Court wishes to pay upon the account of this debt. I have sat in many conferences with this Court and the various representatives of the several parties in interest. It was my understanding when your Honor went away on your vacation that the thing had given you such tremendous worry that you wanted us to sit down and have ready for Honor a rule to show cause returnable the first day that you returned paying to the State of New Jersey an amount of approximately $22,000,000. You asked the Trustee before you went whether or not that amount was available and you were informed that this Debtor could pay that amount of money.

Now, we are willing to take any amount of money that [fol. 498] this Court wishes to pay to us. We believe that

in justice to the State of New Jersey, we believe that in justice to this Debtor, itself, you should make a substantial payment because if $16,000,000 should be paid at this time and it is properly applied at least $800,000, and maybe $1,000,000 of interest will be saved on this particular running of interest.

The Court: Are you willing to accept payments of sums of money which would total principal and interest for a year or a series of years under which it would be clear that the payment is made under protest and subject to the right of this taxpayer to the protection of the statute, 54: 29A-29, which you are familiar with, which provides that,

"Any taxpayer may pay the amount of an assessment into the State treasury, notwithstanding litigation may be pending as to the validity of the whole or any part of said tax, and if it shall be determined in any litigation that the whole or any part of the tax so paid has been unlawfully assessed or imposed, the State Treasurer shall give credit for such overpayment to the taxpayer so paying, upon the taxes next legally levied and payable into the State treasury subsequent to the determination of any such litigation."

That is found in Public Laws 1941, Chapter 291.

Mr. Van Tine: We are willing to accept it on that term, yes, sir.

The Court: I just wanted to know.

Now, then, I would like to ask— Do you want to be heard?

Mr. Hershenstein: No.

The Court: I want to ask a question of those in favor [fol. 499] of the payment. There is a figure mentioned in the petition, $13,438,669.19. How is that total arived at?

Mr. Oliver: That amount is the Trustee's figure but I understand it is an amount equivalent to the principal amount of taxes.

Mr. Carpenter: I can answer that. That is the principal amount of the taxes as shown in the claim filed by the State.

The Court: Well, now, by the paying of that there would not be any protection against the running of penalties would there?

Mr. Carpenter: That is the trouble. Now, the State hollers so about not having been paid this money, they don't say don't tell your Honor that the trustees have

tendered to the State over $8,000,000 but the State can't accept it because of the authorities, Wilentz against Hendrickson and on the Oliphant theory because they——

The Court: You know that the $8,000,000 offered the State on principal was refused by the State?

Mr. Carpenter: The State has consistently refused to apply it to principal.

The Court: Well now they say they are willing to accept it, or any sum; reserving to the Trustee a right to the protection of the statute that I have just read.

Mr. Carpenter: If your Honor please, I do not consider that statute is a sufficient protection to this court and its trustee.

The Court: Why?

Mr. Carpenter: Because it doesn't apply to this situation, these taxes. It can't be contended that these taxes are unlawfully assessed or imposed.

The Court: Why can't it if you claim that the sum total of each year comprises a fund made up of penalty, as [fol. 500] you call it, and the tax itself? Always through these proceedings the attacks have been made upon the interest as being penalties. If we were to pay the different years what years are there that this would total up to, '32 to '39?

Mr. Carpenter: The $13,000,000 covers the principal taxes to 1932 to 1940, inclusive.

The Court: To 1940, inclusive. Without any payment of interest?

Mr. Carpenter: That's right. Now, if we could pay that to the State and thereby stop the accuring of any further penalty——

The Court: If you paid that that would not stop the running of interest, would it?

Mr. Van Tine: Not all of it. If the court should ultimately determine that all the state had coming to it was $13,000,000 then of course it would stop the running of interest, but in the event it were determined that more than $13,000,000 were due, then it would become necessary to apply the amount of money——

The Court: What I would like to know, would it stop the running of interest on the amount that we deposit?

Mr. Van Tine: It would stop the running of interest on the part of that amount which would be credited to principal.

The Court: Well, now, the moment you get this money, the State gets this money, I assume it would credit it on interest——

Mr. Van Tine: No, if your Honor were to make an order to this effect, that——

The Court: —and if you did credit it on interest the interest on the principal would still be running.

Mr. Carpenter: Right.

Mr. Van Tine: If your Honor makes an order in this tenor: This amount is being paid upon the tax debt without [fol. 501] any determination as to how it shall be applied, without prejudice to any one of the parties to make any legal argument with reference to the applications or the amount due, provided, however, that in the event that an amount in excess of the $16,000,000 should be found to be due and payable, then the $16,000,000 will be applied toward the extinguishment of the total debt of those tax years which shall be determined by the Trustee and the bondholders—meaning that in that event if they pay the '40, '39, '38, '37, and '36 taxes with that $16,000,000—and provided further that in the event that it should be determined that less than $16,000,000 is due and payable, then that the excess over and above that which was found to be actually due and payable would be credited to the next taxes, pursuant to that statute, and we will accept payment on such an order.

Mr. Conford: I would like to point, if your Honor please, —I think it has been attempted to be stated but perhaps it is not clear—there are two problems, as I see it before the Court. The first is the form of the order with respect to how these moneys should be paid and the second problem is how much should be paid. I think the understanding of the second one, how much should be paid, partially depends upon the first problem.

The Court: Well, my offhand view of it from the argument here, and I may not continue to have the same opinion after the argument is concluded, is that what I would like to do is to pay the amount that they suggest here and in addition thereto whatever amounts there are now in the hands of the State Treasurer. What is that?

Mr. Van Tine: Three million six.

The Court: Three million six.

[fol. 502] Mr. Conford: May I submit a thought?

The Court: Now, if three million six were added to the thirteen million, personally I would like it very much if that can be done and at the same time the Trustee can be protected on an issue which, gentlemen, has never yet been solved, notwithstanding all you have said, and that is whether or not in so far as bankruptcy is concerned that interest is a penalty. The question is still open.

And let me explain the reason why I say notwithstanding the decisions of the State courts: As you undoubtedly know, the law in so far as the Federal field is concerned is not as static as it was in former years, kaleidoscopic changes have taken place.

Up until a month ago I felt that the law was well established that the question as to whether a partnership existed was a question to be solved under Erie Railroad against Tompkins, by virtue of the law of the State.

The United States Supreme Court has now held that the law of the State has no application in a tax proceeding because it is for the Federal courts, themselves, to build up a corpus juris, which I think would be equivalent to the common law where taxes are concerned under the Revenue Act.

Therefore, Erie Railroad against Tompkins has no application in the case of a Federal tax.

Moreover, there is an opinion that just came down yesterday that Mr. Carpenter called my attention to—let me have that; have you got it here?—wherein the United States Supreme Court has held in a bankruptcy case that the law of the State is not to be followed. It seems to me as I read it that it is almost in conflict with the full faith and credit clause, but that doesn't seem to mean anything, either.

[fol. 503] It says, "In determining what judgments are proveable and what objections may be made to their proof, and in determining the extent to which the equitable conduct of a claimant in acquiring or asserting his claim in bankruptcy, requires its rejection or its subordination to other claims which, in other respects are of the same class, the Bankruptcy Court is defining and applying Federal, not State, law."

Now, if that is followed through to a final conclusion there can be no question at all but that this court, notwithstanding your penalty clause and your decisions in the State of New Jersey, would have the right to look at this tax problem

and solve it on the basis of equity and good conscience in the exercise of its equity power.

Therefore, these changes that have taken place, it has been because men who were well versed in the law realize the issues that are now pending before the United States Supreme Court.

And there is another one that I anticipate a decision on next week wherein it may well be if the Court follows the Lusthaus case, and which it has done in the case which I just stated, that the Court will come back in a bankruptcy case and say, "You will have exclusive jurisdiction," and pass upon whether 12 per cent is a penalty or interest where the interest has never been more than six per cent. It may be that the Supreme Court will say it is. It is my view they ought to if they follow what the Court has heretofore followed in regard to interpreting.

Here was a judgment in the case I have just read from and it had been fought out in the State courts on the ground that there had been no service of process and on the ground that the amount involved constituted a fraud. They went [fol. 504] through the State courts and they went through the Federal courts to have that judgment set aside, to no effect, and finally when bankruptcy supervened it went to the United States Supreme Court and there the whole subject was opened and the law of the State was cast aside.

Now, in the Tower case, handed down last month, the United States Supreme Court clearly holds that in the case of partnership income tax the law of the State means nothing because the Federal court will fix its own interpretation upon what a partnership is. All of which is contrary to the views that I have heretofore held, myself, but yet nevertheless that is the law and I will follow it.

Therefore, when you argue that this case has always been all one way you are greatly mistaken, the issues here have been controverted constantly from the beginning.

I will say this: that your case of Wilentz against Hendrickson certainly did repeal all the law there was prior to that time because the old New Jersey cases always held that interest on taxes, as distinguished from interest on a debt, were penalties. There are very strong dissents in this State take that very opinion. This isn't all one way.

Now for the first time we have an opportunity on an application for the writ of certiorari now pending to have the United States Supreme Court pass upon the question

whether or not this court has jurisdiction to pass upon the extent and validity of a tax claim or whether the court is bound by State decisions with relation thereto in bankruptcy. They have taken the first step against you, Mr. Van Tine, in this bankruptcy case when they look at judgment and construe it according to the bankruptcy idea and not [fol. 505] according to the law of the State. Now, I just say that to answer your proposition that it is all so simple; it isn't.

Now, what I would like to do——

Mr. Oliver: May we state our position, if your Honor please, so the record will disclose it, without argument at all?

The Court: Yes.

Mr. Oliver: I appear here on behalf of the Institutional Group, as you know, and I am always authorized to appear on behalf of the other two organized committees of bondholders, one known as the Brooks Committee, represented by Mr. William A. Roberts of Washington, D. C., and the other committee known as the Watters Committee of Bondholders, represented by Mr. Thomas Raeburn White of Philadelphia.

These three groups of bondholders join in asking that a payment be made on account of taxes. You know very well our position, you have known it for several years on that subject and I won't take your Honor's time to argue upon it.

I want to say that in connection with the presentation made by the Central Hanover, it is our feeling that on the question of a lien on cash it is not material here whether that cash be earned in Pennsylvania or whether it be earned in New Jersey. We have never thought that anyone seriously contended that the State had the first lien on that cash. But regardless of that the determinative question is whether or not it is the wise thing to do in the best interest of the property, to use this cash to pay a part of this prior lien against the property as a whole, and it is the judgment of our people, our own committee, composed of nine outstanding financial people, that it is the wise thing to do; and it is likewise the judgment of the other two committes.

[fol. 506] The Court: I would like to ask, Major, in that connection whether you favor the payment as it is set forth in the prayer of this petition or whether you favor a larger payment?

Mr. Oliver: Well, let me say this: For the purposes of this present proceeding we don't want to do anything which would embarrass Mr. Carpenter, counsel for the Trustee, in his petition for certiorari.

We have felt that if you make a payment equivalent to the principal due, which is about $13,400,000, plus an additional amount equivalent to three per cent interest since 1941, the date of the compromise act on that principal amount, which would aggregate, we believe, somewhere around $16,000,000, that such a payment would not prejudice the Trustee and ourselves in seeking to rectify the injustices caused by this heavy penalty because even though we succeed in all of our demands we would still owe the principal amount and I don't see how in good conscience we could avoid payment of the three per cent interest provided in the Settlement Act on that principal amount since the date of the Settlement Act. So if you paid $16,000,000, or approximately that amount, which it seems to me the Trustee can spare safely, then you will have done nothing to prejudice the counsel for the Trustee in his efforts to rectify what we believe to be injustices, and would also stop the running of interest on that amount.

Now, we suggest——

The Court: Well, it depends upon how the State would credit it.

Mr. Oliver: No, I think there is a very practical way of handling it, if your Honor please, and I think the State will probably agree to that method. I have not discussed the [fol. 507] matter with counsel for the Trustee or the State either, but what could be done, your order could provide that this amount would be payable on account and the allocation to be made in accordance with the final decision in the case.

The Court: Well, now, just a minute, just hold right there. It is after one o'clock and time to go to lunch. What you have just said seems to be a pretty good solution. May I suggest that you convene in chambers at two o'clock and draw an order and let it be passed around to counsel and see how near you can agree because what you just said as you closed is in agreement with Mr. Van Tine, who represents the State.

I would like to know whether anyone else has anything to offer?

(No response.)

Now, before I can get to a discussion on it I have to read the language of an order, and there is where the difficulty is in the fixing of an order.

I now rule that I intend and will recommend payment; the amount is open until the coming in of the presentation of an order after counsel have examined it, and then if there are objections to that order I will hear them. I want to finish this today, time is money in this case. Therefore, we will recess now and reconvene as soon after two o'clock as possible and I will ask counsel to draw an order and then after that is done I will hear counsel on that order.

[fol. 508] Noon Recess

(Counsel met in private session and at 4 p. m. proceedings continued as follows:)

The Court: We are now reconvened in open court for the purpose of considering the form of the order which I understand counsel have conferred on during the recess period.

Mr. Carpenter: I now submit, if your Honor please, a form of order that was prepared by Major Oliver and his office and which has been examined by all parties and approved by the State of New Jersey by its Attorney General.

It provides for the payment by the Trustee to the State within ten days the sum of $15,250,000 cash on account of tax claims of the State for the years '32 to '40, inclusive, including interest thereon, if any. Payment to be made under the conditions specified in the order.

The Court: Is there anyone present who desires to offer any objection to the form and substance of this order?

(No response.)

The Court: Apparently there are no objections. You may submit the order.

(The order was submitted and, after examination, was signed by the Court.)

The Court: Gentlemen, I desire to express the thanks of the Court for your cooperation in arriving at a solution of what has been more or less difficult.

Thank you very much.

The court stands adjourned.

[fol. 509] Copy

STATE OF NEW JERSEY, DEPARTMENT OF TAXATION AND FINANCE, HOMER C. ZINK, COMMISSIONER, TRENTON 7

May 6, 1946.

Hon. Walter P. Gardner, Trustee,
The Central Railroad Company of New Jersey,
Jersey City Terminal,
Jersey City 2, New Jersey.

Dear Judge:

I acknowledge receipt of check for $15,250,000, enclosed in your letter of May 6, 1946, tendered pursuant to Order No. 333, entered April 26, 1946 in the District Court of the United States for the District of New Jersey, in the pending case entitled "In the Matter of The Central Railroad Company of New Jersey, Debtor. In Proceedings for the Reorganization of a Railroad No. 29,778."

Yours truly,

(S) HOMER C. ZINK, Commissioner,

Department of Taxation and Finance.

HCZ:A

[fol. 510] UNITED STATES OF AMERICA, DISTRICT OF NEW JERSEY

I, William H. Tallyn, Clerk of the District Court of the United States for the District of New Jersey, do hereby certify that the printed documents annexed hereto, numbered 1 to 29 inclusive, which are set forth in Exhibit "A" annexed hereto, being numbered 1 to 29, inclusive, are true copies of portions of the record in the District Court of the United States for the District of New Jersey in the proceedings for the reorganization of The Central Railroad Company of New Jersey, No. 29,778, as the same remain of record, and on file in my office.

In testimony whereof, I have hereunto subscribed my name and affixed the seal of said Court, at Newark, in said

District, this 31st day of July, A. D. nineteen hundred and forty-six.

William H. Tallyn, Clerk. By Michael Oller, Jr., Deputy Clerk.

[fol. 511] [File endorsement omitted.]

Endorsed on cover: File No. 50,846, U. S. Circuit Court of Appeals, Third Circuit, Term No. 92. Walter P. Gardner, Trustee of The Central Railroad Company of New Jersey, Petitioner, vs. The State of New Jersey. Petition for a writ of certiorari and exhibit thereto. Filed April 20, 1946. Term No. 92 O. T. 1946.

FILE COPY

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CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1945

No. [redacted] 92

WALTER P. GARDNER, Trustee of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY,

A Debtor-Petitioner,

vs.

THE STATE OF NEW JERSEY,

A Creditor.

PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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THE STATE OF NEW JERSEY

A Creditor.

PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF.

To the Honorable The Chief Justice and the Associate Justices of the Supreme Court of the United States:

WALTER P. GARDNER, surviving trustee of The Central Railroad Company of New Jersey, a debtor corporation in bankruptcy under Section 77 of the Bankruptcy Act, petitions for a writ of certiorari to review a decision of the Circuit Court of Appeals for the Third Circuit reversing Order No. 271 of the United States District Court for the District of New Jersey sitting in bankruptcy.

Jurisdiction.

Judgment of the Circuit Court of Appeals was entered November 15, 1945. The opinion of the Circuit Court of Appeals is reported in 152 Fed. (2d) 408. A petition for rehearing was denied March 28, 1946. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, 28 U.S.C. Section 347(a) as amended by the Act of February 13, 1925.

The Nature of the Proceedings.

This case arises from a petition of the trustees to the District Court to determine these essential questions:

(1) Whether a compromise had been entered into between the State of New Jersey (which had filed a claim in the proceedings for balances of taxes assessed by the State upon property and franchises of the debtor for the years 1932 to 1939 both inclusive in the amount of $12,117,450.68, plus interest thereon in the sum of $7,732,339.53, plus additional interest at 1% per month on the unpaid taxes from December 1, 1940 to the date of payment) and the trustees, under and in strict compliance with Railroad Tax Settlement Acts passed by the State, under which, before the constitutionality of said Acts was determined the trustees on court order had accepted the offer of settlement therein contained; had discontinued all pending appeals from taxes; had made payments of disputed taxes that would not otherwise have been paid; after all of which it was impossible to have the *status quo* reinstated.

(2) Whether, if no contract of compromise existed, to what extent the claim of the State against the debtor should be allowed in the bankruptcy proceeding; and

(3) What are the relative rights, claims, liens and priorities of the claimants in the assets of the debtor's estate.

Upon the filing of said petition the Attorney General of New Jersey filed a special appearance and contended that the Bankruptcy Court was without jurisdiction to make the determination of the matters aforesaid, on the ground that the petition of the trustees constituted a suit against the State without its consent. The District Court thereupon referred the matter to a Special Master, who filed an Interim Report that the entire property of the railroad is in *custodia legis,* and that the Bankruptcy Court is the proper court to determine the validity and amount of the tax claims of the State and incidental liens and that the Trustees Petition for adjudication of liens should not be dismissed. Objections were filed by the State to this report, and the District Court after a hearing made Order No. 271 confirming the Interim Report of the Special Master. The attorney general appealed from this order. Before the case was heard in the Circuit Court of Appeals the Attorney General of the State filed in the Circuit Court of Appeals a petition for writ of prohibition praying that the Circuit Court of Appeals forbid the District Court and Special Master from making any adjudication in connection with the tax debt liens of the State.

The Circuit Court of Appeals denied the petition for a writ of prohibition and in its opinion said:

> "the only matters left open for the Bankruptcy Court to pass upon are: (1) Mathematical error in the computation of the amount of the tax, or (2) Legal error in its assessment. * * *
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> "In No. 8889 Order No. 271 of the District Court is reversed. This disposes of the entire matter before us. The application for a writ of prohibition

in No. 8861 is therefore dismissed, without costs to either party as against the other."

This, when read with the judgment reversing Order 271, was an instruction that the amount of the state's taxes and penalties and the lien asserted was *res judicata* and no longer open to further litigation.

The trustee filed a petition for rehearing asserting that the Court had misconceived the questions involved on the appeal and had determined the matter as though only the assessments and amount of taxes were involved, whereas the questions actually presented are those above stated relating to the status of the compromise under the Railroad Tax Settlement Acts, the rate of interest to be allowed on the State's claim, and the nature and extent of the liens against the debtor's property. The petition for rehearing was denied, and this petition for a writ of certiorari is filed within due time.

The Questions Presented.

I.

Does the Bankruptcy Court have jurisdiction to determine the nature and extent of liens of a State for taxes assessed against the property and franchises of a railroad in reorganization under Section 77 of the Bankruptcy Act and in particular the rate of interest or penalties to be allowed thereon after bankruptcy?

II.

Where trustees in bankruptcy have accepted, pursuant to court order, an offer of settlement contained in statutes of the claimant State, and in compliance with such statutes have abandoned all pending contests of the amount and nature of assessments, and the *status quo* cannot be re-

stored, does the later determination by the State Courts that the Settlement Acts are unconstitutional in a proceeding to which the trustees in bankruptcy were not parties, prevent the Bankruptcy Court from itself determining whether or not the State's claim for taxes and penalties was compromised in accordance with the provisions of Sec. 27 of the Bankruptcy Act (11 U. S. C. A. Sec. 50) and must be allowed and paid over a period of years, and at a reduced rate of interest, as fixed by the Tax Settlement Acts?

III.

Is not the jurisdiction of the Bankruptcy Court to make such determination clear where the decision of the State Court was made on the finding that there was no moral or equitable consideration to support the State's remitting, cancelling and abating the interest and penalties accruing against the several railroads doing business in the State, and that consequently the statute amounted to a "donation of land or appropriation of money" in violation of a provision of the State Constitution; whereas in the case at bar the debtor Railroad was unable to pay the taxes and continue its public functions, and the consideration to support the settlement was the discontinuance of litigation involving the taxes and the payment of retroactively assessed additional taxes without contest?

Summary Statement of Matters Involved.

On October 30, 1939 The Central Railroad Company of New Jersey, hereafter called the "Debtor", filed its petition in the District Court for the District of New Jersey under Section 77 of the Bankruptcy Act, because the State had threatened to enter judgment and sell its properties located within the State for nonpayment of 1932 and 1933

taxes, litigation concerning which had resulted unfavorably to the debtor. Trustees were appointed for the debtor on January 8, 1940. The State of New Jersey by its Comptroller filed a claim for taxes, which specified the amount of taxes due for each year from 1932 to 1939 inclusive, the balance remaining unpaid for each year and the interest and penalties that had accrued to the date of bankruptcy App. 82a-87a). At this time practically all the railroads in New Jersey were in default in the payment of their franchise and property taxes and a number were in bankruptcy. The Governor of the State appointed a committee to investigate the railroad tax problem, which had resulted to a major extent from a grossly inflated tax rate, and that committee, on February 22, 1941, made a comprehensive report which was subsequently considered by a committee of the Legislature, with the result that Chapters 290 and 291 of the Laws of 1941 were passed and approved and became effective July 22, 1941. Chapter 291, P. L. 1941, was a new Railroad Tax Act providing for taxes on both the franchises and properties of railroads doing business in the State. This act, in Sec. 75 repealed the former tax act under which the taxes were assessed, and in Sec. 54 attempted both to preserve the taxes theretofore assessed and also to *extend the lien* to revenues and other personal property not theretofore covered by a state lien. (See brief annexed, p. 30.)

By the provisions of Chapter 290 the State Treasurer was authorized and required to accept, without interest penalties, instalment payments of the principal amount of the taxes assessed and unpaid for the years 1932 to 1940 inclusive,* provided the railroad taxpayer complied with Sections 7 and 8 of said Act, which provided as follows:

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* A true copy of Chapter 290, the 1941 Tax Settlement Act is printed in the appendix hereto.

"7. Undertaking; first payment. Any railroad or system, or the receiver, trustee or trustees thereof, may enter upon the execution of an installment payment plan authorized under this act by (1) duly executing and filing with the State Comptroller a written undertaking, in such form as the Attorney-General shall prescribe, for the payment of the total amount of delinquent taxes owed by the railroad or system and (2) paying into the State treasury an amount not less than the first annual installment together with interest on the unpaid balance computed in the manner provided by sections two, three and four of this act.

"8. Waivers. The first payment tendered pursuant to this act shall be accompanied by a waiver of any and all rights to contest the legality or amount of any assessment made prior to December first, one thousand nine hundred and forty-one, together with stipulations, consents or other papers for the discontinuance and dismissal of all suits, actions, and proceedings pending in any court or before the Board of Tax Appeals concerning such assessments, all in such form as the Attorney-General may require."

On August 8, 1941 the District Court considered this statutory offer of settlement and authorized the trustees of the debtor to accept the compromise of said tax claims by agreeing to pay the full unpaid balance of the principal amount of taxes assessed from 1932 to 1940 inclusive, said payments to be made in instalments over a period of twenty years, as authorized by said Act, without penalties but with interest at three percent per annum, computed from December 1, 1940 as required by the terms of said offer (app. 62a, par. 14).

The trustees thereupon filed with and delivered to the appropriate officer of the State all the documents and pay-

ments required for full compliance by them and subsidiary companies with the conditions of said offer and the order of the Court. After this had been done, and on September 4, 1941, the Attorney General, David T. Wilentz instituted a proceeding in the Court of Chancery of New Jersey against the State Treasurer, Hendrickson as defendant, attacking the constitutionality of Chapter 290 (app. 63a).

Neither the debtor nor its trustees, nor any railroad was a party to this suit in the Court of Chancery instituted by the Attorney General against the State Treasurer, Hendrickson.

Before the enactment of Chapter 290 aforesaid your trustees had appealed to the New Jersey State Board of Tax Appeals from the assessment of railroad taxes made for the year 1941. The taxes for the years 1934-1940, inclusive, were all in litigation before various administrative tribunals and courts. Having accepted the State's offer of compromise on court order, they paid the taxes assessed for 1941 and discontinued all appeals and pending litigation over the taxes as assessed for the years 1932 to 1941 inclusive. While *Wilentz* v. *Hendrickson* above mentioned was still pending undetermined, the Legislature enacted Chapter 169, P.L. 1942, effective May 8, 1942, amending certain provisions of Chapter 291, P.L. 1941 (the new Railroad Tax Act), so as to levy a retroactive franchise tax against the debtor for the preceding year 1941 in the additional amount of $239,749.80, but which law also operated to reduce the franchise taxes assessed for 1941 against most of the other railroads operating in New Jersey and completely to eliminate from franchise taxes certain other railroads operating in New Jersey. Petitioner believed that said Chapter arbitrarily and unjustly discriminated as between members of the class of railroad taxpayers subject to the Railroad Tax Act of the State and singled out the

debtor as a victim of an arbitrary recomputation of the 1941 franchise taxes, while at the same time financially benefiting other railroad taxpayers (app. 65a).

Thereupon the Legislature of New Jersey enacted Chapter 241, P.L. 1942 approved and effective May 21, 1942, amending in various respects Chapter 290, P.L. 1941 (the Tax Settlement Act).* Chapter 241 added various burdens and conditions to those imposed upon the debtor by the Act which it amended. Among other things it provided that:

> "taxpayer desiring to accept the provisions of this act shall, on or before June 15th, nineteen hundred and forty-two, file with the State Treasurer the acceptance documents required by this act * * * waiving any and all rights to contest the legality or amount of any assessment on its property used for railroad purposes made prior to December 1st, nineteen hundred and forty-one, *pursuant to the applicable tax acts and of any assessment heretofore or hereafter made for the tax year nineteen hundred and forty-one.* * * *"

To accept the benefit of the 1942 Tax Settlement Act the trustees were required unequivocally to abandon their challenge of the retroactive additional franchise tax for 1941 in the amount of $239,748.80, and to incorporate in their "Acceptance Document" their written waiver of "any and all rights to contest the legality or amount" of said retroactive franchise tax assessment, and also any other tax that might thereafter be assessed for said year, or risk the contention that they had abandoned their acceptance of the State's offer or had failed in any respect to comply therewith in good faith. The Trustees were also required by Chapter 241 to make an additional interest payment on or

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* A true copy of Chapter 241, P. L. 1942, is printed in the appendix hereto.

before June 15, 1942 in an amount exceeding $340,000.00 which resulted from the requirement of accelerated payment of interest and the requirement that interest be computed from December 1, 1940 upon the entire principal amount of taxes claimed by the State as of that date, without deducting therefrom the first instalment of principal previously computed. The trustees had only between May 21, 1942 when this act was approved and June 15, 1942 to secure court approval of the acceptance of the settlement contained in Chapter 241, P.L. 1942, and to comply therewith. This approval was obtained, and the Act was fully complied with by the trustees making the payments and filing all the documents and papers required by State law (App. 66a-68a).

The very day that Chapter 241, P.L. 1942 was approved by the Governor, Vice Chancellor Jayne in *Wilentz* v. *Hendrickson* granted an order to show cause restraining the State Treasurer from carrying out or executing any of its provisions.*

Over a year after the trustees had compiled, and caused their four affiliated companies to comply with Chapter 241, P.L. 1942, and had in good faith waived all of their rights of contest and had paid without contest the retroactive franchise tax of $239,748.80 and the additional and accelerated interest above mentioned, the Court of Chancery, on September 28, 1943, entered a final decree in *Wilentz* v. *Hendrickson*, reported 133 N.J. Eq. 447. The Vice Chancellor held that the Railroad Settlement Acts vio-

*The State Treasurer has not cashed certified checks tendered by the trustees for taxes assessed before 1940. The trustees have preserved their rights to date by making legal tenders of all amounts due to date according to the terms of the Tax Settlement Acts, and said tenders are being kept good. The State Treasurer is holding, uncashed, trustees certified checks aggregating $3,577,689.52. The total of certified checks both held and rejected by the State Treasurer is $8,571,874.46.

lated Article I, Paragraph 20 of the New Jersey Constitution, which provides:

> "No donation of land or appropriation of money shall be made by the State or any municipal corporation, to or for the use of any society, association or corporation whatever."

The State Treasurer duly appealed to the New Jersey Court of Errors and Appeals, which, on June 22, 1944 filed its opinion affirming the decree of the Vice Chancellor, on the ground that the remission, cancellation and abatement of the delinquent interest due from the railroads in the State was not supported by a legal, equitable or moral consideration and that accordingly Art. I, Par. 20 of the Constitution was violated. *Wilentz* v. *Hendrickson*, 135 N. J. Eq. 244, 260.

The order of the District Court which directed the trustees of the debtor to comply with Chapter 241, P.L. 1942, on or before June 15, 1942, also fixed and determined the amount of the State's claim for taxes. The Attorney General of the State appealed from this order, on the ground among others, that it in fact determined that the Tax Settlement Acts were constitutional, a question that had not been argued, and the Circuit Court of Appeals reversed so much of the order as determined the amount of taxes due the State and said:

> "One final point must be noticed. Order No. 163 authorizes the trustees of the debtor to comply with the Tax Settlement Acts by executing and filing the documents and making the payments therein required. Since the law directed that these steps be taken on or before June 15, 1942, it is vitally important to the debtor, in case the constitutionality of the Tax Settlement Acts is ultimately sustained, that the

tenders made by the trustees prior to that date, pursuant to the directions of Order No. 163, be not invalidated by the reversal of that order. Accordingly so much of paragraphs 6 and 7 of Order No. 163 as authorizes the trustee to comply with the requirements of the Tax Settlement Acts will not be disturbed."

The cause was remanded

> "with directions to the District Court to await the determination by the Court of Chancery of the State of New Jersey of the constitutionality of the Railroad Tax Settlement Acts, unless it finds that delay which may be harmful to the Debtor and its creditors may result, in which event it may proceed itself to hear and decide the constitutional issue."

In re Central Railroad Company of New Jersey, 136 Fed. (2d) 633; rehearing denied July 15, 1942. This court denied certiorari 320 U. S. 805.

Within two months after the decision of the Court of Errors and Appeals in *Wilentz* v. *Hendrickson,* 135 N. J. Eq. 244, and on August 14, 1944, the trustees herein filed their "Petition for Adjudication Concerning New Jersey Tax Claims" (App. 55a), in which they stated the facts as hereinabove contained concerning the taxes assessed, the litigation respecting taxes, and what had been done to comply with the Tax Settlement Acts, and prayed the Court promptly adjudicate (1) whether petitioners entered into a contract with the State of New Jersey, (2) whether such contract is binding on the parties thereto, (3) whether, if not binding on the State, petitioners are nonetheless bound by the prejudicial actions taken by them, (4) if not binding on the parties thereto including petitioners, to what extent, if at all, the proofs of claim of the State of New Jersey should be allowed, (5) what order should in such event be

made to restore the equivalent of the status quo ante as nearly as may be and (6) what in such event are the relative rights, claims, liens and priorities of the claimants in the assets of the Debtor's Estate (App. 79a).

The Attorney General, after being served with a copy of this petition, filed a special appearance and alleged that the District Court did not have jurisdiction to make the determination prayed for (App. 100a). The District Court thereupon referred the matter and the State's objections to the Special Master by Order No. 250 (App. 103a). The Special Master made his interim report (App. 148a) in favor of the court's jurisdiction, which was confirmed after hearing objections filed by the State by Order No. 271, which is involved in this appeal (App. 177a). Since the Circuit Court of Appeals denied the State's petition for a writ of prohibition, that is not brought before this Court.

Reasons Why a Writ of Certiorari Should Issue.

I.

The Circuit Court of Appeals by its decision passed upon matters not properly before it and which had not been passed upon by the Bankruptcy Court, consequently its judgment is erroneous, and must be reversed with instructions to the Bankruptcy Court to decide the matters presented by the Trustees' petition.

The judgment of the Circuit Court of Appeals has deprived the Bankruptcy Court of its essential jurisdiction to pass upon these questions:—

(A) Whether the Bankruptcy Court has jurisdiction under Section 77 to determine the nature and extent of a State's lien for taxes on a claim filed in the proceedings, and, in particular, the rate of interest or penalties to be allowed thereon after bankruptcy.

The effect of the judgment of the Circuit Court of Appeals is to deny this jurisdiction. The necessity for the exercise of such jurisdiction is emphasized by the State's repeal of its statute under which the taxes were assessed, and the passage of a new Tax Act which attempted both to *save* the lien of the taxes formerly assessed and *extend the lien* given by the former law to cover additional property (see Brief annexed, pages 27, 28); and by the passage of the Tax Settlement Acts and the consequences thereof to the estate of the debtor. Furthermore, the priorities of liens of bondholders and the State, if any, on the various classes of railroad properties affected by such liens must be determined under Section 67 (B) and (C) and Section 64 (A) 4 of the Bankruptcy Act.

Incidental questions arise whether, because of the facts and circumstances of this case the Bankruptcy Court should not in any event exercise its equity jurisdiction to do equity (Section 77 (A) and Section 2-a of the Bankruptcy Act), by determining that in no event should the State's claim carry penalty interest at 1% per month, but only compensatory interest at a lesser rate (Section 57 (J) of the Bankruptcy Act); or, that because of the tenders made by the Trustees to the State which have been kept good, the running of interest and penalties was stopped by such tenders. *Shields* v. *Lozear*, 22 N. J. Eq. 447; *Nelson* v. *Loder*, 132 N. Y. 288.

Under these circumstances, "while valid liens existing at the time of the commencement of a bankruptcy proceeding are preserved, it is solely within the power of a court of bankruptcy to ascertain their validity and amount and to decree the method of their liquidation." *Isaacs* v. *Hobbs Tie & Timber Co.*, 282 U.S. 734, 738, and cases cited.

Straton v. *New*, 283 U. S. 318.

B. *The question is presented whether the State made a valid and binding agreement of compromise with an officer of the Bankruptcy Court.* There was a solemn offer, contained in paragraph 7 of the 1941 Act (page 41 hereof), to the trustees of debtor to settle the tax claims of the State. This offer was duly accepted under the orders of the Bankruptcy Court and the consideration was paid before any attack was made on the constitutionality of the Act. The rights that flowed from such acceptance must be determined by the Bankruptcy Court.

The Circuit Court of Appeals has prevented decision of the question whether a State which has filed in reorganization proceedings a claim for taxes and penalties is bound by the provisions of Section 27 of the Bankruptcy Act, 11 U.S.C.A., Section 50, which provides:

> "A trustee may, with the approval of the court, compromise any controversy arising in the administration of the estate upon such terms as he may deem for the best interests of the estate."

There is ample precedent for a bankruptcy court to settle claims against or in favor of an estate in bankruptcy.

Drexel v. *Loomis* (8th Cir.), 35 Fed. (2d) 800;
Pullman Couch Co. v. *Eshelman* (4th Cir.), 1 Fed. (2d) 885;
In re Riggi Bros., Inc. (2nd Cir.), 42 Fed. (2d) 174;
In re Van Camp Products Co., 95 Fed. (2d) 206; cert. den. 305 U.S. 605.

When an individual compromises a claim against the estate with court approval:

> "The court after approval has power by summary order to hold a defaulting offeror to performance of the compromise. This because the offeror by making his offer has subjected himself to the jur-

isdiction of the court so far as the compromise is concerned."

In re Sobod, Inc., 25 Fed. Supp. 344; affirmed 103 Fed. (2d) 1019;

Re Hollingsworth & Whitney Co., (1st Cir.) 242 Fed. 753.

The case of a judicial sale is a fair analogy. A court which has ordered a sale of property in its care may order a defaulting purchaser to carry out the bargain he made. *Camden* v. *Mayhew*, 129 U.S. 73; *In re Rival Knitting Company*, (2nd Cir.) 289 Fed. 960.

Certainly where the claimant is a State a different rule of law should not apply, for the offer of compromise was made by the Legislature with the Governor's approval, which is the most solemn form of offer of compromise that a State could make. Moreover, the State had prior to passage of the statute entered the proceedings as a creditor and its verified claim was before the court for allowance and adjudication. Moreover, that very claim asserted a lien and a priority over all creditors (App. 82a).

The docket entries show that the State had appeared in the proceedings on December 15, 1939, December 2, 1940, March 26, 1941, and on December 12, 1944 it filed an elaborate Reply to "Supplemental and Amended Objections and Defenses of Debtor's Trustees to Claims Filed by the State of New Jersey (App. 115a-142a).

Assuming for purposes of argument that the Trustee's petition for an adjudication of the State's claim for taxes was a suit against the State, which we deny, by filing a claim to recover its tax debt the State has waived its immunity from suit.

Clark v. *Barnard*, 108 U. S. 436, 447;

Gunter v. *Atlantic Coast Line*, 200 U. S. 273, 284;

Porto Rico v. *Ramos*, 232 U. S. 627.

The language of Section 27 of the Bankruptcy Act that a trustee may "compromise any controversy arising in the administration of the Estate", is broad enough to include controversies with municipalities, states and the Federal Government, as well as claims of individuals.

Our contention that the debtor's estate is entitled to the benefits of the compromise is supported by the decisions of this Court, the Circuit Court of Appeals for the Third Circuit, and the New Jersey Courts.

> "The actual existence of a statute, prior to such a determination (of unconstitutionality) is an operative fact and may have consequences which cannot justly be ignored. The past cannot always be erased by a new judicial declaration. The effect of the subsequent ruling as to invalidity may have to be considered in various aspects—with respect to particular relations, individual and corporate, and particular conduct, private and official. Questions of rights claimed to have become vested, of status, of prior determinations deemed to have finality and acted upon accordingly, of public policy in the light of the nature both of the statute and of its previous application, demand examination." Chief Justice Hughes in *Chicot County Drainage Dist.* v. *Baxter State Bank*, 308 U. S. 371, 374.

J. A. Dougherty & Sons v. *Commissioner of Internal Revenue* (C. C. A. 3d), 121 Fed. Rep. (2d) 700; *The Coast Company* v. *Spring Lake*, 56 N. J. Eq. 615, 620; *Attorney General* v. *Dover*, 62 N. J. L. 138, 140; *Lang* v. *Bayonne*, 74 N. J. L. 455; *In Re Public Utility Board*, 83 N. J. L. 303; *Hyman* v. *Long Branch Kennel Club*, 115 N. J. L. 123.

In effect the Circuit Court of Appeals has ruled that the Bankruptcy Court must follow the decision of the Court of

Errors and Appeals in *Wilentz* v. *Hendrickson*, 135 N. J. Eq. 244, without any hearing or adjudication of the questions here presented. The trustee contends that this decision is not *res judicata* and does not have the support of the doctrine of *stare decisis* under the rule in *Erie Railroad* v. *Tompkins*, 304 U. S. 64, for the reason that it was tried on ex parte affidavits and on an agreed statement of facts, was between the Attorney General of the State as complainant and only the State Treasurer as defendant, and merely resulted in a decree restraining the State Treasurer from complying with the Act. The rule in New Jersey is that:

> "A decision based upon stipulated facts that results in declaring a law unconstitutional does not wipe the act from the statute books, but merely denies its efficacy to a party who has admitted the existence of a state of facts that in the opinion of the court renders the law unconstitutional." (Justice Pitney in *Rutten* v. *Paterson*, 73 N. J. L. 467, 475.)

The opinion of the Court of Errors and Appeals was in the nature of an advisory opinion.

> *In re Opinion of the Justices*, 266 Mass. 590; 165 N. E. 904;
> *Prawl* v. *Burckhartt*, 299 Ill. 19; 132 N. E. 280.

That the Act might be held unconstitutional in the contest between two State Officers on a stipulation of facts, and yet be constitutional as to the trustees of the debtor who had complied with the Act giving a valid and legal consideration in acceptance of the offer of settlement contained therein, is indicated by the severability clause of the

Settlement Act of 1941, as amended by Chapter 241 of the Laws of 1942. See annexed appendix, p. 42 (Par. 12); p. 54 (Par. 15):

> "If any provision of this Act or the application thereof to any person or circumstances is held invalid, the remainder of this Act, or the application thereof to other persons or circumstances shall not be affected thereby."

Whether debtor's estate shall have the benefit of this clause of the Settlement Acts is for the Bankruptcy Court to decide. *Isaacs* v. *Hobbs Tie & Timber Co.*, 282 U. S. 734; *Straton* v. *New*, 283 U. S. 318.

In *Arkansas Corporation Commission* v. *Thompson*, 313 U. S. 132, the trustee was denied the right to have taxes against a railroad's property redetermined and revised in the Bankruptcy Court because he had deliberately failed and neglected to take the appeal to the State reviewing agency, and thence to the courts as the State law permitted. In this case the trustees had taken and were prosecuting all the appeals and legal proceedings provided under the State laws when the Legislature passed, and the Governor approved the Tax Settlement Acts. The trustees, with the court's approval, accepted the offer of compromise contained in the 1941 act and did everything required by the State law to comply with its terms.*

When the 1942 amendment was passed the court and trustees had only six weeks within which to comply with the settlement offer as contained in the statute, and on court

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* The Attorney General declined to approve the settlement papers tendered before he filed his suit in the Court of Chancery. This was merely a ministerial act and it has never been asserted that the papers tendered were not a full compliance with the statute.

order, after notice to the State and all other parties, they fully complied within that time and made every payment and delivered every document required by the statute.* The payment of taxes and the discontinuance of the appeals and litigation amounted to giving the State adequate consideration to constitute a valid contract of settlement. Consideration may be a detriment incurred by the grantee, or a benefit received by the grantor. A trifling inconvenience to the one party or a slight advantage to the other is sufficient to constitute lawful consideration. *National Bank* v. *Bloom*, 113 N. J. L. 597, 602 (E. & Ap.).

A State's claim for franchise taxes was ordered reduced and allowed for the reduced amount in *New Jersey* v. *Anderson*, 203 U.S. 483. In the case at bar the trustee does not contend for a reduction in the principal amount of the taxes as assessed. His insistment is that under all the facts and circumstances of this case the principal of the State's claim for taxes is payable in installments, and that penalties at one percent per month from the dates of the respective annual assessments must be reduced to three percent per annum from December 1st, 1940 on all unpaid installments because of the contract of settlement and compromise that flowed from the Tax Settlement acts.**

The questions presented by this petition have never been decided in any litigation involving the debtor and its estate. We have examined the petition for a writ of certiorari filed by the trustees to review the decision of the

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* The 1942 Act prescribed the form of documents to be delivered and the approval of the Attorney General as to form was not required.

** The principal of taxes claimed by the State to be due is $13,438,668.19 (including in addition to the taxes shown in the State's proof of claim a balance of 1940 taxes of $1,321,218.51); penalties of 1% a month to March 1, 1946 are believed to aggregate $16,267,563.36, a total of about $29,706,231.55.

Circuit Court of Appeals for the Third Circuit in *In Re Central Railroad Company of New Jersey,* 136 Fed. (2d) 633; cert. den., *Pitney, et al., Trustees* v. *State of New Jersey,* 320 U. S. 805 (No. 534, October Term, 1943). Counsel believe that the court denied a writ at that time because the Circuit Court of Appeals made no final determination but sent the case back to the District Court to await the decision of the State Courts, giving that court, however, the right to decide the question of constitutionality of the Tax Settlement Acts before the decision of the State Courts if that were necessary.

Indeed, the brief of the Attorney General of New Jersey filed in opposition to the granting of a writ of certiorari to the trustees of the debtor (No. 534 Oct. Term 1943), stated that there was nothing in the record then before the court effective to bar the Bankruptcy Court from making a determination as to the amount and validity of the tax claims of the State under Sections 77 and 64 of the Bankruptcy Act, after the Court of Errors and Appeals had determined the pending appeal from the Court of Chancery (State's Brief, pp. 8, 9, 13, 14, 18).

Prayer.

For the foregoing reasons your petitioner prays that a writ of certiorari may issue out of this court to the United States Circuit Court of Appeals for the Third Circuit, commanding said Court to certify and send to this Court on a day to be determined, the full and complete transcript of the record of all the proceedings of such Circuit Court of Appeals had in this case, to the end that the case may be reviewed and determined by this Court;

that the judgment of the Circuit Court of Appeals be reversed, and that petitioner be granted such other and further relief as may be proper.

Dated April 18, 1946.

WALTER P. GARDNER,
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BRIEF IN SUPPORT OF PETITION.

Opinions Below.

The District Court's opinion appears in the Appendix page 175a. The opinion of the Circuit Court of Appeals is reported 152 Fed. (2d) 408 and is annexed to the Appendix, the record below. The Special Master's Interim Report is in the Appendix, page 148a.

Statement of the Case.

A summary statement of the case is given in the petition, pages 5-13 above.

It seems appropriate, however, to emphasize that a fundamental error in the Circuit Court's decision is that by reversing the Bankruptcy Court's order which merely dealt with jurisdiction, the Circuit Court's decision in effect anticipates and undertakes to dispose of meritorious issues as to which the petitioner has had no hearing. Certain of these issues will be defined below.

POINT I.

The Bankruptcy Court had jurisdiction to determine the nature and extent of the State's lien for taxes on a claim filed in the proceedings, and, in particular, the rate of interest or penalties to be allowed thereon after bankruptcy.

The principal amount due on the claims of the State had on to be conceded by the trustees when they accepted the offer of settlement that was contained in the Railroad

Tax Settlement Acts of 1941 and 1942 which were duly passed by the Legislature of New Jersey and approved by the Governor. The trustee asserts the right of the debtor to pay the principal of these taxes in instalments over a period of twenty years, as provided in the Tax Settlement Acts. He further claims that the interest on all taxes unpaid runs at three percent per annum only from December 1, 1940 instead of at the rate of one percent per month from December 1st of the year of the respective assessments as claimed by the State in its claim on file. The claim of the State appears in the Appendix as Schedule "A", page 82a (see Petition for Adjudication, App. 55a).

At the time the trustees of the debtor were appointed, it was the settled law in New Jersey that taxes in arrears due to the State might be compromised, and also that the interest of one percent per month was a penalty and not a part of the tax.

> *Town of Belvidere* v. *Warren Railroad Co.*, 34 N. J. L. 193;
> *Dixon* v. *Jersey City*, 37 N. J. L. 39;
> *Camden* v. *Allen*, 26 N. J. L. 398;
> *Pennsylvania T. & T. Co.* v. *Gummere*, 87 N. J. L. 358.

In a powerful dissenting opinion of Justice (now Chief Justice) Case, in *Wilentz* v. *Hendrickson*, 135 N. J. Eq. 261, 281, Justice Case said:

> "By the weight of judicial decisions in this State the percentum addition, whatever name be given to it, is not a part of the tax. It is a form of remedy provided for the collection of the tax. The statute which authorizes the addition may be lawfully re-

pealed, and with the repeal the obligation to pay ceases. Control thereover is within the province of the Legislature."

The majority opinion in *Wilentz* v. *Hendrickson*, 135 N. J. Eq. 244, changed the pre-existing law and held that the penalties specified as such in the statute were in fact interest and a part of the tax debt which could not be compromised unless the State received valuable consideration therefor.

It is clear from the authorities cited in the dissenting opinion of Justice Case that the District Court and the trustees were fully justified in believing when they accepted the provisions of compromise in the Tax Settlement Act, that such compromise was authorized by State law.

A. The Bankruptcy Court has exclusive jurisdiction, from the date a petition is filed, over liens and claims asserted against a debtor.

In 1845, in *Ex parte The City Bank of New Orleans*, 3 How. 291, 11 L. Ed. 603 (Story, J.), it was held that the District Court when sitting in bankruptcy has jurisdiction over liens and mortgages existing upon the property of the bankrupt so as to inquire into their validity and extent and grant the same relief which the State courts might or ought to grant.

The same case held that the control of the District Courts over proceedings in the State courts upon such liens is exercised not over the State courts themselves, but upon the parties, through an injunction or other appropriate proceeding in equity.

See, also:

Taubel &c. v. *Fox*, 264 U. S. 426;
Nisbit v. *Federal Title & G. Co.*, 229 Fed. 644;
Isaacs v. *Hobbs Tie & Timber Co.*, 282 U. S. 374.

Upon adjudication in bankruptcy,

> "The jurisdiction of the bankruptcy court becomes paramount and exclusive, and thereafter that court's possession and control of the estate cannot be affected by proceedings in other courts, whether State or Federal."
>
> *Gross* v. *Irving Trust Co.*, 289 U. S. 342, 344;
> *Acme Harvesting Co.* v. *Beekman Lumber Co.*, 222 U. S. 300, 307;
> *Re Diamond*, 259 Fed. 70, 73;
> *Taylor* v. *Sternberg*, 293 U. S. 470, 472.

The provisions of Section 77 of the Bankruptcy Act permitting a railroad corporation which is insolvent, or unable to meet its debts as they mature, to effect a plan of reorganization through a proceeding in a bankruptcy court, are within the power conferred upon Congress by Art. I, §8, Cl. 4, of the Federal Constitution, to establish uniform laws on the subject of bankruptcies throughout the United States.

> *Continental Illinois Natl. & Trust Co.* v. *Chicago Rock Island Pacific Ry. Co.*, 294 U. S. 648.

An important question presented by the trustees' petition for determination of liens, which must be determined before the Railroad can be reorganized, is as to the priority of liens under Section 64 of the Bankruptcy Act between the State of New Jersey and the bondholders. This question is accentuated in importance by the attempt of New Jersey to extend its liens to the revenues of the Railroad and "all the real and personal property owned, used or controlled by the taxpayer within this State".

While the Trustees' petition did not attempt to specify all the liens that must be determined by the District Court, nevertheless the reference to the Special Master that was made on the Trustees' Petition for Adjudication of the Railroad claims was broad enough to require the Special Master to determine priorities between all the various lien holders.

The effect of the judgment of the Circuit Court of Appeals is to deny the jurisdiction of the Bankruptcy Court to determine the nature and extent of the various liens on the properties of the debtor, and particularly priorities as between the several lien claims in such properties.

When it is considered that ever since the compromise of the State's claim under the 1941 and 1942 Tax Settlement Acts was accomplished, so far as the District Court and the trustees could complete it, penalties have been accumulating, according to the State's contention, at the rate of over $130,000 a month and at this time exceed the principal amount of the taxes claimed by the State by over $3,000,000, the gravity of the questions involved becomes apparent.

If the Circuit Court of Appeals rendered its opinion and judgment with the thought in mind that the questions presented by the Trustees' petition might be settled in a plan of reorganization, the court was grievously mistaken.

How can an intelligent plan of reorganization be prepared until the classes of creditors and the nature and extent and amount of the various liens are determined? Moreover, before a plan is prepared the Interstate Commerce Commission, the Court, and all parties in interest must know whether the principal of the taxes must be paid in full or whether the debtor's estate has the right to pay in instalments over a period of twenty years so much of

the principal as cannot be paid in cash. This privilege was given by the Tax Settlement Acts.

In addition, the Interstate Commerce Commission, the Court and all parties in interest must know whether the principal of the taxes carries interest at three percent per annum as fixed by the Tax Settlement Acts, or penalties of one percent per month as provided by the Railroad Tax Act, or some other compensatory interest. The difference aggregates over $14,000,000.

We submit that since the Bankruptcy Court has taken jurisdiction of the debtor railroad, and all of its funds and property are *in custodia legis*, the Bankruptcy Court has full and complete jurisdiction to make all necessary determinations respecting the questions here involved, what payments should be made by the trustee to the State, and how such payments shall be applied on the State's claim.

B. Under bankruptcy law the State has no lien on the personal property of the debtor.

Proof of Claim No. 38 filed by the State, in answer to the fourth question in the blank, read:

"Security or lien, if any, for said claim:

"Answered in (10) below" (App. 83a).

Referring to question 10 the Proof of Claim said:

"(10) Lien, priority or preferential classification, if any, claimed for the claim, or any part thereof, the reasons therefor and full statement of the facts respecting same:

"The statute of New Jersey provides that these taxes shall be a lien paramount to all other liens upon all the lands and tangible porperty and fran-

chises of the company in this State (Section 9, Chapter 208, P. L. 1888, as amended and supplemented; Section 54:27-4, Revised Statutes). The lien shall take effect on June 1 of the year in which the tax is payable'' (App. 84a).

It is submitted that under the express provisions of the Bankruptcy Act and applicable decisions the lien of the mortgage securing the bonds issued by the debtor is prior to the claim of the State to have a lien on the tangible and intangible personal property of the debtor located in New Jersey and elsewhere.

Bankruptcy Act, Sec. 67 (b) and (c), (11 U. S. C. A. 107 (b) and (c)):

Bankruptcy Act, Sec. 64 (11 U. S. C. A. 104);

New York v. *Maclay*, 288 U. S. 290;

United States v. *Texas*, 314 U. S. 480;

City of New Orleans v. *Harrell*, 134 Fed. (2d) 399 (C. C. A. 5th);

City of New York v. *Hall*, 139 Fed. (2d) 935 (C. C. A. 2nd).

In re Pennsylvania Central Brewing Co., 114 Fed. (2d) 1010 (C. C. A. 3rd); cert. den. 312 U. S. 685.

Sections 64 and 67 of the Bankruptcy Act are applicable to railroad reorganizations under Section 77.

Lyford v. *New York*, 140 Fed. (2d) 840 (C. C. A. 2nd).

POINT II.

The State repealed its Railroad Tax Law and attempted by a new Tax Act to preserve its taxes as assessed and preserve and extend its lien after bankruptcy had occurred.

The State's Proof of Claim for taxes asserts a lien under par. 10, Sec. 9, Ch. 208, P. L. 1888, as amended and supplemented; Sec. 54:27-4, Revised Statutes, N. J.

This section of the statute, which is a part of the Railroad Tax Act, provides:

> "54:27-4. *Default; penalty; remedies; liens.*
>
> "If the taxes of any company, or any part thereof, remain unpaid on December 1st following the levying thereof, the company shall be considered in default, and such taxes, or the unpaid portion thereof, shall thenceforth bear interest at the rate of one percent for each month until paid. Notwithstanding the prosecution of a writ of certiorari or other remedy the taxes shall be a lien paramount to all other liens upon all the lands and tangible property and franchises of the company in this State. The liens shall take effect on June 1st of the year in which the tax is payable and shall be a debt due from the company to the State on that date for which an action at law or suit in equity may be maintained, and shall be a preferred debt in case of insolvency. These remedies are in addition to the special proceedings provided for in Chapters 19 to 29 of this Title (Sec. 54:19-1, *et seq.*)."

The above section was repealed by Section 75, Chapter 291, P. L. 1941; (Rev. 54:29A-75 (Pamphlet)), (New Tax Act).

The New Tax Act contained the following provisions:

"54:29A-53. *Interest.* Taxes heretofore imposed pursuant to any law for the taxation of property used for railroad and canal purposes, or hereafter imposed pursuant to this Act, or any unpaid portion thereof, shall bear interest from and after the date upon which they became or may become due and delinquent at the rate of one percentum (1%) for each month until paid notwithstanding the prosecution of a writ of certiorari or other remedy."

"54:29A-54. *Lien of Taxes.* The taxes imposed by this Act or heretofore imposed pursuant to any act for the taxation of property used for railroad and canal purposes, shall be and remain a lien paramount to all other liens upon the revenues and all the real and personal property owned, used or controlled by the taxpayer within this State. The lien shall take effect as of the 1st day of the year in which the tax is payable."

"54:29A-55. *Tax a debt; preference.* The taxes imposed by this Act or heretofore imposed shall be and remain a debt due from the taxpayer to the State for which an action at law or suit in equity may be maintained and shall be a preferred debt in case of insolvency."

A comparison of the old and the new sections of the Tax Act shows an attempt to extend the lien of the State to assets of the debtor and other railroads that were not covered by the old law. The State now contends that its lien extends to "the *revenues* of the debtor", as well as to personal property *controlled* by the debtor, assets which were not subject to the State's alleged lien prior to 1941.

It is also to be observed that the former law provided that the liens shall take effect on June 1st of the year in which the tax is payable and become a debt from that date,

whereas the 1941 law provides that "the lien shall take effect as of of the first day of the *year* in which the tax is payable". We know of no authority for a creditor, whether it be a State or mortgagee, to change and extend a lien on a bankrupt's property after a petition in bankruptcy has been filed. Upon the filing of the petition in bankruptcy the rights of the bankrupt, or debtor, creditors and stockholders, became fixed.

Straton v. *New*, 283 U. S. 318.

What happened to the lien asserted by the State under the old law, in existence when the petition was filed by the debtor, when the State passed the 1941 Tax Act, which in Section 75 expressly repealed the former law under which the taxes in question were assessed and the liens created?

Were such liens preserved by Section 54 of the repealing Act, which provided that the taxes heretofore "imposed pursuant to any act for the taxation of property used for railroad and canal purposes shall be and remain a lien paramount to all other liens"? The intent, of course, was to preserve the State's rights in all such liens. It was further the intention to extend such liens to the revenues of the Railroad and other property not covered by the original lien.

In *State, Dixon, Pros.* v. *Jersey City*, 37 N. J. L. 39, taxes were assessed under a provision of the Jersey City Charter of 1870, and before the taxes in question were paid a new charter was passed for the City which made no provision for the collection of taxes theretofore assessed, and repealed the 1870 Charter without saving assessments made under it. By a supplement to the Charter of Jersey City of 1872 it was enacted that nothing in the Charter of 1871 should be construed to impair the right which the City had

before the passage of that Act to any taxes or assessments theretofore levied or to any penalties or interest theretofore accrued. The State Supreme Court held:

> "The power to impose the forfeiture attaches as a necessary incident to the right to levy and collect taxes, and on no other ground can it be supported. The penalty thus provided is not taxation; it is merely a method of enforcing the payment of a tax, and it could not be sustained as a distinct measure for raising revenue, separable from the tax itself. The imposition of penalties for past omissions would be sanctioned by no such reason or necessity; it would not be in aid of the collection of the revenue, but would be arbitrary exaction from which the citizen could in no way escape. I can find in no text book nor in any adjudicated case, any definition of taxation which will embrace a proceeding like the one involved in this controversy. It would be confiscation, not taxation."

Concluding his opinion, Justice Van Syckel said:

> "When part of a tax is illegal, all proceedings to collect it must be void, as it is impossible to separate what is legal from what is illegal."

Pennsylvania Tunnel & Terminal Co. v. *Gummere*, 87 N. J. L. 353.

We have no doubt that if a mortgagee, after a petition in bankruptcy had been filed against an individual or corporate debtor, had cancelled his mortgage and simultaneously had taken and recorded from the bankrupt a new mortgage covering property in addition to that covered by the original mortgage, it would be held that the lien of the cancelled mortgage was extinguished even though the new mortgage contained the provision that it "shall be and remain a lien paramount to all other liens" on the property

of the bankrupt. We know of no authority sustaining the right of a State to alter and extend its lien after a court of Bankruptcy had obtained jurisdiction by repealing the old and enacting a new law in the manner indicated. We are confident that an important and novel question was presented by the trustees' petition for the adjudication of the State's liens.

It is respectfully submitted that a writ of certiorari should issue in accordance with the prayer of the trustee's petition.

Respectfully submitted,

JAMES D. CARPENTER, JR.,
HOWARD L. KERN,
ALEXANDER H. ELDER,
Of Counsel with the Trustee.

Appendix.

A. Applicable Provisions of the Bankruptcy Act.

Section 2 a (2) of the Bankruptcy Act (11 U. S. C. A., Chapter 2, Section 11 a (2):

"Sec. 11. Creation of courts of bankruptcy and their jurisdiction

a. The courts of the United States hereinbefore defined as courts of bankruptcy are hereby created courts of bankruptcy and are hereby invested, * * * with such jurisdiction at law and in equity as will enable them to * * * (2) Allow claims, disallow claims, reconsider allowed or disallowed claims, and allow or disallow them against bankrupt estates; * * * (7) Cause the estates of bankrupts to be collected, reduced to money and distributed, and determine controversies in relation thereto, except as herein otherwise provided, * * * (15) Make such orders, issue such process, and enter such judgments, in addition to those specifically provided for, as may be necessary for the enforcement of the provisions of this title: * * *"

Section 57 of the Bankruptcy Act (11 U. S. C. A. 93):

"Sec. 57. *Proof and Allowance of Claims.* * * *

"j. Debts owing to the United States or any State or subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law.

"k. Claims which have been allowed may be reconsidered for cause and reallowed or rejected in whole or in part according to the equities of the case, before but not after the estate has been closed.

"n. Except as otherwise provided in this title, all claims provable under this title, including all claims

of the United States and of any State or subdivision thereof, shall be proved and filed in the manner provided in this section * * *".

Section 64 of the Bankruptcy Act (11 U. S. C. A. 104a):

"Sec. 64. *Debts Which Have Priority.* The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be * * * (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof: Provided, That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court: And provided further, That, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court; * * *"

Sec. 67. Liens and fraudulent transfers (11 U. S. C. A. 107):

"b. The provisions of section 96 of this title to the contrary notwithstanding, * * * statutory liens for taxes and debts owing to the United States or any State or subdivision thereof, created or recognized by the laws of the United States or of any State, may be valid against the trustee, even though arising or perfected while the debtor is insolvent and within four months prior to the filing of the petition in bankruptcy or of the original petition under chapter 10, 11, 12, or 13 of this title, by or against him. Where by such laws such liens are required to be perfected and arise but are not perfected before bankruptcy, they may nevertheless be valid, if perfected within the time permitted by and in accordance with the requirements of such laws, except that if such laws require the liens to be perfected by the seizure of property, they shall instead be perfected by filing notice thereof with the court.

c. Where not enforced by sale before the filing of a petition in bankruptcy or of an original petition under chapter 10, 11, 12, or 13 of this title, though

valid under subdivision b of this section, statutory liens, including liens for taxes or debts owing to the United States or any State or subdivision thereof, on personal property not accompanied by possession of such property, * * * shall be postponed in payment to the debts specified in clauses (1) and (2) of subdivision a of Section 104 of this title, * * *"

Section 77(b) (11 U. S. C. A. 205):

"A plan of reorganization within the meaning of this section (1) shall include provisions modifying or altering the rights of creditors generally, or of any class of them, secured or unsecured, either through the issuance of new securities of any character or otherwise; * * * (3) may include, for the purpose of preserving such interests of creditors and stockholders as are not otherwise provided for, provisions for the issuance to any such creditor or stockholder of options or warrants to receive, or to subscribe for, securities of the reorganized company in such amounts and upon such terms and conditions as may be set forth in the plan; (4) * * * (5) * * *"

" * * * The term 'creditors' shall include, for all purposes of this section all holders of claims of whatever character against the debtor or its property, whether or not such claims would otherwise constitute provable claims under this Act, including the holder of a claim under a contract executory in whole or in part including an unexpired lease.

"The term 'claims' includes debts, whether liquidated or unliquidated, securities (other than stock and option warrants to subscribe to stock), liens, or other interests of whatever character * * *."

B. Chapter 290, Laws of 1941 (N. J.)

CHAPTER 290

AN ACT relating to the collection of certain delinquent taxes upon railroad companies.

WHEREAS, Certain taxes levied for the years 1932 through 1940 upon property used for railroad purposes in this State are delinquent and unpaid, and the total accumulated delinquencies, exclusive of interest penalties, amounted to more than thirty-four million dollars ($34,000,000.00) as of December thirty-first, one thousand nine hundred and forty; and

WHEREAS, Four of the railroad systems serving this State are or have recently been in reorganization under Federal bankruptcy laws, and there is serious doubt as to the ability of the railroads operating in the State to pay the delinquent taxes, and at the same time to continue to furnish adequate and safe service; and

WHEREAS, The limited area of New Jersey and its intensive industrial development make it peculiarly dependent upon efficient transportation, particularly because of the present demands of production for national defense, and immediate payment of accumulated tax delinquencies would impair the capacity of the delinquent railroads to furnish such transportation service; and

WHEREAS, The unpaid railroad taxes have tended to create a chaotic condition in State and municipal finances, and the entire State has an urgent and important interest in the immediate solution of the question of delinquent railroad taxes and in the maintenance of stable transportation facilities and public finances; now therefore,

BE IT ENACTED *by the Senate and General Assembly of the State of New Jersey:*

1. Installment payments. The State Treasurer is hereby authorized and required to accept, without interest

penalties, installment payments of the full principal amount of property taxes upon railroad companies, which were due on or before December first, one thousand nine hundred and forty, and remain unpaid on the effective date of this act. But the State Treasurer shall not accept any installment payments under the terms of this act unless and until the delinquent taxpayer shall have complied with the requirements of sections seven and eight hereof.

2. Maximum period. The total principal amount of delinquent taxes payable under this act shall be paid in full, in accordance with the respective capacity to pay of each railroad system and of each railroad company not part of a system, within a maximum period from and after December first, one thousand nine hundred and forty, determined as the whole number of years next greater than seven times its "burden index," computed as hereinafter set forth, except that each taxpayer shall be allowed at least two years, and no taxpayer shall be allowed more than twenty years.

The burden index shall be determined for each railroad system, and for each company not part of a system, by dividing its total amount of delinquent taxes as of December thirty-first, one thousand nine hundred and forty, by the five-year average of its net railway operating income, for the years one thousand nine hundred and thirty-six through one thousand nine hundred and forty, inclusive. Any system or railroad not part of a system whose average net railway operating income is not a positive sum shall be allowed the maximum period of twenty years.

For the purpose of this act, a railroad system shall be deemed to consist of an operating railroad reporting to the Interstate Commerce Commission for the year one thousand nine hundred and forty and all the companies included in its report of system operations.

3. Date and amount. Installment payments shall be made on or before December first in each year. Each annual installment shall be not less than such amount as, together

with all prior installment payments, shall leave a balance remaining due the ratio of which to the total principal amount of delinquent taxes payable hereunder shall not exceed the ratio of the number of unexpired years to the total number of years of the maximum period permitted under section two of this act.

4. Interest. All interest penalties upon taxes paid pursuant to this act shall be abated and cancelled, except that, in addition to installment payments, interest at the rate of three per centum (3%) per annum shall be paid annually upon the balance of delinquent taxes remaining unpaid from and after December first, one thousand nine hundred and forty.

5. Discharge of lien. The liens of the State for taxes and interest penalties of each year for which delinquent taxes are payable pursuant to this act shall be fully satisfied and discharged, in the order in which such taxes accrued, when and as principal payments on account thereof equal or exceed the full principal amount delinquent for any tax year, and interest upon all unpaid balances has been paid in full.

6. Liens preserved. The remedies of the State for the collection of delinquent taxes payable pursuant to the provisions of this act shall not be enforced against any taxpayer which enters upon the execution of an installment payment plan hereunder, in the manner provided by section seven hereof, so long as installment payments and interest upon the unpaid balances continue to be paid on or before the respective due dates. Upon default in payment of all or part of an installment payable in any year or of interest upon the unpaid balance, the whole remaining amount of delinquencies including interest penalties, shall, subject to the provisions of section five of this act, be reinstated and become due and payable thirty days after the date of default. Nothing in this section shall be construed to deprive any taxpayer of credit for installment payments

upon the principal amount of delinquencies made prior to such default.

7. Undertaking; first payment. Any railroad or system, or the receiver, trustee or trustees thereof, may enter upon the execution of an installment payment plan authorized under this act by (1) duly executing and filing with the State Comptroller a written undertaking, in such form as the Attorney-General shall prescribe, for the payment of the total amount of delinquent taxes owed by the railroad or system and (2) paying into the State treasury an amount not less than the first annual installment together with interest on the unpaid balance computed in the manner provided by sections two, three and four of this act.

8. Waivers. The first payment tendered pursuant to this act shall be accompanied by a waiver of any and all rights to contest the legality or amount of any assessment made prior to December first, one thousand nine hundred and forty-one, together with stipulations, consents or other papers for the discontinuance and dismissal of all suits, actions, and proceedings pending in any court or before the Board of Tax Appeals concerning such assessments, all in such form as the Attorney-General may require.

9. Consents in reorganizations. The Attorney-General is hereby authorized and directed to execute in the name of the State of New Jersey any and all consents to a plan or plans of reorganization of a railroad corporation, under Federal bankruptcy or other laws, to the extent that such plan provides for payments to the State on claims for taxes in accordance with the provisions of the act.

10. Construction. Nothing in this act shall be construed to affect the payment and collection of taxes other than assessments made under chapters nineteen to twenty-nine of Title 54 of the Revised Statutes; nor shall any provision of this act be construed to authorize or recognize any

claim for any refund, return or credit of all or part of the taxes of any company heretofore paid for any year.

11. Distribution of receipts. The monies collected by the State Treasurer pursuant to this act shall be subject to distribution, opportionment or appropriation as heretofore provided by law. The State Treasurer shall credit receipts hereunder to delinquent accounts in the order in which the delinquent taxes were originally assessed.

12. Effect of unconstitutionality. If any provision of this act, or the application thereof to any person or circumstances, is held invalid, the remainder of this act, or application of such provision to other persons or circumstances, shall not be affected thereby.

13. Effective date. This act shall take effect immediately.

Approved July 22, 1941.

C. Chapter 241, Laws of 1942 (N. J.)

CHAPTER 241

AN ACT to amend the title of "An Act relating to the collection of certain delinquent taxes upon railroad companies," approved July twenty-second, one thousand nine hundred and forty-one (1941, c. 290) so that the same shall read "An act providing for the collection of unpaid taxes heretofore assessed upon property used for railroad purposes, for any or all of the years one thousand nine hundred and thirty-two to one thousand nine hundred and forty, inclusive, and also providing for the remission of unpaid interest penalties with respect to taxes heretofore assessed upon such property for any or all of said years," and to amend the body of said act and to supplement said act.

BE IT ENACTED *by the Senate and General Assembly of the State of New Jersey:*

1. The title of "An act relating to the collection of certain delinquent taxes upon railroad companies," approved July twenty-second, one thousand nine hundred and forty-one (1941, c. 290) is amended to read "An act providing for the collection of unpaid taxes heretofore assessed upon property used for railroad purposes, for any or all of the years one thousand nine hundred and thirty-two to one thousand nine hundred and forty, inclusive, and also providing for the remission of unpaid interest penalties with respect to taxes heretofore assessed upon such property for any or all of said years."

2. Section one of the act of which this act is amendatory and supplementary is amended to read as follows:

1. Any railroad taxpayer desiring to accept the provisions of this act shall, on or before June fifteenth, one thousand nine hundred and forty-two, file with the State Treas-

urer the acceptance document required by this act, providing for the payment in full of the principal amount of all of its unpaid taxes for the tax years involved at the times and in the manner provided by this act and waiving any and all rights to contest the legality or amount of any assessment on its property used for railroad purposes made prior to December first, one thousand nine hundred and forty-one pursuant to the applicable tax acts, and of any assessment heretofore or hereafter made for the tax year one thousand nine hundred and forty-one; and shall also file with the State Treasurer a written consent to the discontinuance and dismissal of any and all suits, actions and proceedings pending in any court or before the State Board of Tax Appeals respecting any such assessments; and shall also at the same time pay to the State Treasurer the initial payment provided for by this act. The State Treasurer is hereby authorized and required to accept payment of such unpaid taxes when made in accordance with the terms of this act.

3. Section two of the act of which this act is amendatory and supplementary, is amended to read as follows:

2. The total principal amount of unpaid taxes payable under this act shall be paid in full, and such payment may be made in installments as herein provided, in accordance with the respective capacity to pay of each railroad system and of each railroad company not part of a system, within a maximum period from and after December first, one thousand nine hundred and forty, which shall be the whole number of years next greater than seven times its "burden index," computed as hereinafter set forth, except that each taxpayer shall be allowed at least two years, and no taxpayer shall be allowed more than twenty years.

The burden index shall be computed for each railroad system, and for each company not part of a system, by dividing its total amount of unpaid taxes as of December thirty-first, one thousand nine hundred and forty, by the five-year average of its net railway operating income, for

the years one thousand nine hundred and thirty-six through one thousand nine hundred and forty, inclusive. Any system or railroad not part of a system whose average net railway operating income is not a positive sum shall be allowed the maximum period of twenty years.

4. Section three of the act of which this act is amendatory and supplementary is amended to read as follows:

3. The initial payment to be made under this act shall be made on or before June fifteenth, one thousand nine hundred and forty-two, and shall be an amount not less than the first annual installment computed as herein provided. After the payment of the initial installment on or before June fifteenth, one thousand nine hundred and forty-two, as required by this act, an additional installment payment shall be made on or before December first, one thousand nine hundred and forty-two, and in each year thereafter on or before December first of said year. Each such annual installment shall be not less than such amount as, together with all prior installment payments, shall leave a balance remaining due the ratio of which to the total principal amount of unpaid taxes payable hereunder shall not exceed the ratio of the number of unexpired years to the total number of years of the maximum period permitted under this act.

All such unpaid taxes shall bear interest at the rate of three per centum (3%) per annum, to be calculated from and after December first, one thousand nine hundred and forty. The initial payment shall include such interest to the date of such payment; and each subsequent payment shall include interest at such rate on the unpaid balance of taxes calculated from the date of the next preceding installment payment. Any railroad taxpayer may, however, at the time or times herein specified for the payment of any installment of such taxes, pay the whole amount of taxes then remaining unpaid, together with the interest thereon as herein provided for, or it may at such time or times make payments in amounts in excess

of the required installment payments, together with interest as provided in this act; or such taxpayer may make payment of any installment of taxes payable under this act in advance of the time or times specified by this act, together with the interest accrued to the date of such payment; and in any of such events, further interest shall cease with respect to the amount of the taxes so paid from the date of the payment thereof. Payments made by any railroad taxpayer shall be applied first to the payment of interest at three per centum (3%) per annum as provided by this act, and the amount of any payment in excess thereof shall be applied to the unpaid taxes owing by such taxpayer, in the order in which such taxes became payable under the applicable tax acts.

Should any railroad taxpayer so direct in the acceptance document filed pursuant to this act, the State Treasurer is hereby authorized and required to collect the amount of any drafts or checks heretofore delivered to him by such railroad taxpayer in attempted compliance with the provisions of pamphlet laws of one thousand nine hundred and forty-one, chapter two hundred ninety, and to credit the same to the payments required to be made by such taxpayer under this act. If the amount of any such draft or check is less than the amount of taxes and interest required to be included in the initial payment, such taxpayer at the time of filing its acceptance document shall pay the balance of the initial payment required by this act.

5. Section four of the act of which this act is amendatory and supplementary is amended to read as follows:

4. Upon the acceptance of the provisions of this act by any railroad taxpayer, and as long thereafter as such railroad taxpayer shall make payment of the unpaid taxes and interest required by this act, there is and shall be stayed and suspended any remedy or proceedings to collect any unpaid taxes for the tax years one thousand nine hundred and thirty-two to one thousand nine hundred and forty, inclusive, and any statutory interest penalties with respect to any taxes assessed for said years.

6. Section five of the act of which this act is amendatory and supplementary is amended to read as follows:

5. Whenever any railroad taxpayer accepting the provisions of this act heretofore has paid, or hereafter shall have paid, as required by this act, the full amount of all taxes assessed upon its property used for railroad purposes for the years one thousand nine hundred and thirty-two to one thousand nine hundred and forty, inclusive, and all interest, if any, required by this act, such taxpayer and its property shall be released and discharged from any and all claims for statutory interest penalties with respect to any and all taxes assessed against such taxpayer or upon its property used for railroad purposes for any and all of the tax years one thousand nine hundred and thirty-two to one thousand nine hundred and forty, inclusive.

7. Section six of the act of which this act is amendatory and supplementary is amended to read as follows:

6. Upon default in the making of any payment provided for in the acceptance document, and a continuance thereof for a period of thirty days after the due date of such payment, the then remaining unpaid balance of taxes, together with statutory interest penalties with respect to any and all taxes assessed against such taxpayer or upon its property used for railroad purposes for any of the years one thousand nine hundred and thirty-two to one thousand nine hundred and forty, inclusive, calculated from the original due date of such taxes shall immediately become due and payable, and the State may assert, exercise and enforce any and all rights, claims, demands, liens and privileges with respect thereto as if this act had not been enacted, and in addition thereto may assert and enforce any remedies it may have acquired under such acceptance document except that such taxpayer shall be entitled to a credit against such statutory interest penalties in an amount equal to the interest paid pursuant to the provisions of this act.

8. Section seven of the act of which this act is amendatory and supplementary is amended to read as follows:

7. The acceptance document herein referred to shall be in substantially the following form:

ACCEPTANCE AND WAIVER

The (insert name of railroad or system) does hereby accept the provisions of (insert the amended title of this act), and hereby undertakes and agrees to pay to the State of New Jersey in the manner and at the times prescribed by said act the sum of (insert total amount of taxes unpaid on December 1, 1940), being the total principal amount of taxes remaining unpaid on December 1, 1940, which were theretofore assessed against or levied upon the property used for railroad purposes for the years 1932 to 1940, inclusive, of the (insert name of railroad or system) together with interest thereon, to be computed at the rate of three per centum (3%) per annum from and after December 1, 1940.

(If any railroad taxpayer has heretofore delivered or tendered a draft or check to the State Treasurer on account of any part of such taxes or interest in attempted compliance with the provisions of P. L. 1941, chapter 290, the following clause may be added) "and said (insert name of railroad or system) does hereby authorize and direct the State Treasurer of New Jersey to retain and accept the draft or check heretofore delivered to him on the .....
..... day of .....,
1941, in the amount of .....
dollars, and to collect and credit the same upon the initial payment required to be made by this act."

And said (insert name of railroad or system) for itself and the following companies whose railroads are included in its system, to wit (list of companies) does hereby waive any and all rights under the laws of the State of New Jersey and of the United States to contest the legality or amount of any assessment upon its or their property used for railroad purposes made prior to December 1, 1941, pursuant

to the applicable tax acts and of any assessment heretofore or hereafter made for the tax year 1941.

In Witness Whereof said (insert name of railroad or system) has caused this instrument to be sealed with its corporate seal and attested by its officers thereunto duly authorized, this ..... day of ....., 1942.

(Seal)

(Signatures)

9. Section eight of the act of which this act is amendatory and supplementary is amended to read as follows:

8. The consent to the discontinuance and dismissal of pending appeals and litigation shall be in substantially the following form:

DISCONTINUANCE AND DISMISSAL

(Name of Court or tribunal)

(Names of parties to proceeding)

In re Assessments for (insert tax year)

On motion of (insert name of taxpayer or appellant) it is on this day of , 1942

Ordered that the appeal (or other proceeding) with respect to the taxes and assessments of the property of (insert name of taxpayer or appellant) used for railroad purposes for the tax year be and the same is hereby discontinued and dismissed.

We consent to the foregoing order.

(Signature of attorney for taxpayer or appellant)

10. Section nine of the act of which this act is amendatory and supplementary is amended to read as follows:

9. The Attorney-General is hereby authorized and directed to execute in the name of the State of New Jersey any and all consents and approvals to a plan or plans of reorganization of a railroad corporation, under Federal bankruptcy or other laws, to the extent that such plan provides for payments to the State on claims for taxes in accordance with the provisions of this act.

11. Section ten of the act of which this act is amendatory and supplementary is amended to read as follows:

10. Nothing in this act shall be construed to affect the payment and collection of taxes other than assessments made under the applicable tax acts; nor shall any provision of this act be construed to authorize or recognize any claim for any refund, return or rebate of any part of any taxes of any company heretofore paid for any year by any railroad or system.

12. Section eleven of the act of which this act is amendatory and supplementary is amended to read as follows:

11. The moneys collected by the State Treasurer pursuant to this act shall be subject to distribution, apportionment or appropriation as heretofore provided by law.

13. The act of which this act is amendatory and supplementary is supplemented by adding the following section:

14. As used in this act:

(a) The phrase "tax years involved" is defined to mean any or all of the years one thousand nine hundred and thirty-two to one thousand nine hundred and forty, both inclusive.

(b) The phrase "applicable tax acts" is defined to mean all statutes providing for the assessment and collection of taxes on property used for railroad purposes in effect for any or all of the tax years involved.

(c) The phrase "railroad taxpayer" is defined to mean any railroad system or railroad not part of a system owning or operating a railroad in this State, or the duly appointed and qualified receiver, receivers, trustee or trustees thereof, whose property used for railroad purposes has been assessed for taxes for any of the tax years involved, pursuant to the applicable tax acts as herein defined.

(d) The phrase "statutory interest penalty" is defined to mean the one per centum (1%) per month charges provided by the applicable tax acts or by any other act to be collected in the event of the failure to pay the taxes assessed under the applicable tax acts at the times specified therein.

(e) The word "interest" is defined to mean the interest at three per centum (3%) per annum provided to be paid by this act.

(f) The phrase "acceptance document" is defined to mean the instrument referred to in section seven of this act.

(g) The phrase "railroad system" is defined to mean an operating railroad company reporting to the Interstate Commerce Commission for the year one thousand nine hundred and forty and all companies included in its report of system operations.

14. The act of which this act is amendatory and supplementary is supplemented by adding the following section:

15. The purpose and object of this act is to provide for the payment by railroad taxpayers of unpaid balances of taxes assessed for the tax years involved, pursuant to applicable tax acts, upon property used for railroad purposes in this State, and to that end, it is hereby determined and declared:

Beginning with the year one thousand nine hundred and thirty-two and continuously thereafter, this State, at great expense and with considerable interruption to the orderly disposition of other tax review proceedings by State tribunals, has been engaged in litigation concerning

the validity and amount of assessments upon property used for railroad purposes in this State; and litigation involving substantial amounts of taxes and debatable questions of law and fact relating thereto are still pending and undetermined for certain of the tax years involved.

The development of competitive transportation facilities, the more general use of fuels other than coal, the shrinkage of export rail traffic destined to the Port of New York, the decentralization of industry and other causes, as well as the economic depression of the past decade, adversely affected the financial position and progress of the railroads operating in New Jersey, and although the income of such railroads was substantially decreased from former levels, the tax obligations of such railroads were not materially reduced.

The statutory interest penalty provisions of the applicable tax acts have not proven effectual to accomplish their purpose of assuring prompt payment of taxes, and unpaid balances of taxes for the tax years involved now exceed in the aggregate thirty-four million dollars ($34,000,000.00), exclusive of any claims of the State for statutory interest penalties relating to taxes assessed for the tax years one thousand nine hundred and thirty-two to one thousand nine hundred and forty, inclusive.

The prosecution of statutory legal proceedings under the applicable tax acts to enforce collection of unpaid balances of taxes and statutory interest penalties for the tax years involved has been accompanied by the institution and prosecution by certain railroad taxpayers of appropriate proceedings under Federal bankruptcy laws, resulting in the appointment of receivers or trustees of certain of such railroad taxpayers and their properties. Several railroad taxpayers of this State, whose taxes are in part unpaid, are now involved in such proceedings. It is probable that similar proceedings may be undertaken with respect to other railroad taxpayers and their properties if existing statutory collection proceedings are continued or new proceedings instituted.

Wherever claims for unpaid taxes and statutory interest penalties have been filed on behalf of the State in such bankruptcy proceedings, the provability of the amount of the claims of the State has been questioned and objections have been filed by the receivers or trustees in reorganization to the allowance thereof. Litigation arising in connection therewith is pending in various Federal courts in which the bankruptcy proceedings are pending.

The delay and uncertainty in the collection of the unpaid balances of railroad taxes has created a chaotic condition in State and municipal finances and such tax moneys are urgently needed to pay existing and potential costs of government. It is imperative that a substitute and more effective and feasible method for the collection of such unpaid balances of taxes be provided promptly.

To meet the existing national emergency and aid the effective movement of armed forces and supplies, so that this State and the nation may be protected, it is essential that the railroads in this State be not financially harassed by the continued attempt to collect statutory interest penalties with respect to the taxes assessed for the tax years involved.

For more than fifty years last past, it has been the well recognized and approved public policy and practice of this State and its various agencies and subdivisions to meet financial emergencies resulting from long periods of financial depression by compromising, adjusting, abating and altering the amount and method of payment of obligations of taxpayers.

This Legislature has given consideration to investigations, recommendations, hearings and reports made by various public officials, legislative and other committees, both during the current legislative year and prior thereto, in the matter of taxes assessed on property used for railroad purposes, and has particularly given consideration to a report on the subject made by the Joint Legislative Committee constituted by Senate Concurrent Resolution No. 8 of the one thousand nine hundred and forty-one Legislature, and a report dated

February twenty-second, one thousand nine hundred and forty-one, made by a citizens committee appointed by His Excellency, Charles Edison, Governor of this State.

Certain railroad taxpayers have heretofore attempted to accept the provisions of this act as originally enacted, and as a result thereof, the State Treasurer now has in his possession drafts and checks in an amount in excess of ten million dollars ($10,000,000.00). Questions having arisen respecting the validity and construction of this act as originally enacted, such funds may not be presently available for use by either the State or its various agencies and municipalities. Should changes in financial status result in such drafts or checks becoming uncollectible, or should some or all of such railroad taxpayers undertake to withdraw such drafts or checks and all instruments filed in attempted compliance with said act, serious legal and financial questions may arise as to the rights of the State.

This Legislature has also considered the report made to it by its committee appointed pursuant to Senate Concurrent Resolution No. 2 of the one thousand nine hundred and forty-two Legislature.

After due deliberation and consideration, it is determined and concluded that the existing claims, controversies and litigation above mentioned can best be disposed of, and that the unpaid balances of taxes assessed upon property used for railroad purposes for the tax years involved can best and most quickly be collected, in the manner and upon the terms and conditions herein provided, and that upon the acceptance of, and compliance with, such terms and conditions by any railroad taxpayer the State will have received full, fair and adequate consideration, and the best interests of the State will have been served and furthered.

15. If any provision of this act or the application thereof to any person or circumstances is held invalid, the remainder of this act, or the application thereof to other persons or circumstances, shall not be affected thereby.

16. This act shall take effect immediately.

Approved May 21, 1942.

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IN THE

Supreme Court of the United States

October Term, 1946

No. 92

WALTER P. GARDNER, Trustee of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY,
Petitioner,

vs.

THE STATE OF NEW JERSEY.

BRIEF FOR PETITIONER

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IN THE

Supreme Court of the United States

October Term, 1946

No. 92

WALTER P. GARDNER, Trustee of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY,

Petitioner,

vs.

THE STATE OF NEW JERSEY.

BRIEF FOR PETITIONER

I

Opinions Below

The opinion of the Circuit Court of Appeals for the Third Circuit is reported in 152 Fed. (2d) 408. It is printed in the Record (p. 148). The opinion of the District Court of the United States for the District of New Jersey confirming the Special Master's Interim Report (R. 27), which was reversed by the Circuit Court of Appeals, is not officially reported but appears in the Record (p. 40).

II

Jurisdiction

The jurisdiction of this court is invoked under the Act of February 13, 1925, C. 229, Sec. 1, 43 Stat. 938; USCA Tit. 28, Sec. 347.

The date of the judgment of the Circuit Court of Appeals which reversed Order No. 271 in the matter of The Central Railroad Company of New Jersey reorganization proceedings was November 15, 1945 (R. 168).

The order of this court allowing certiorari was filed June 10, 1946 (R. 147).

III

Statement of the Case

A. Introductory Statement

Petitioner is the surviving trustee of The Central Railroad Company of New Jersey, an interstate railroad which is in reorganization in the District Court of the United States for the District of New Jersey under Section 77 of the Bankruptcy Act.* Debtor's petition for reorganization was filed on October 30, 1939. At that time the State of New Jersey claimed balances of taxes for each of seven years aggregating $11,651,081.86 and additional taxes were claimed to be payable December 1, 1939 in the sum of $3,415,922.05 (R. 192).

The State now claims that interest penalties of one percent. per month have been accruing on the taxes in arrears from the date they originally became due and

---

* Petitioner's co-trustee, Shelton Pitney, Esq., died January 13, 1946.

payable. Although the trustee on court order has made payments on account out of the general assets of the debtor in excess of $18,000,000, the State now contends that there is in excess of $15,000,000 still due it.

This case arises from a petition of the trustees to the District Court (R. 43), filed on August 14, 1944, to determine the following essential questions that arose in the proceedings:

(1) Whether a compromise of the claim for taxes had been entered into between the State of New Jersey and the trustees, under and in strict compliance with Railroad Tax Settlement Acts passed by the State, under which, before the constitutionality of said Acts was determined, the trustees on court order had accepted the offer of settlement therein contained; had discontinued all pending appeals from taxes; and had made payments of other disputed taxes without contest; after all of which it was impossible to have the *status quo ante* reinstated.

(2) Whether, if no such settlement by compromise had been effected, to what extent the claim of the State against the debtor for principal amount of taxes and for interest penalties should be allowed in the bankruptcy proceedings; and

(3) What are the relative rights, claims, liens and priorities of the claimants in the assets of the debtor's estate.

Upon the filing of said petition the Attorney General of New Jersey, although he had previously appeared generally in the proceedings, filed a special appearance (R. 78) and contended that the Bankruptcy Court was without jurisdiction to make the determination of the matters aforesaid, on the ground that the petition of the trustees constituted a suit against the State without its consent. The District Court thereupon referred the matter to a Special

Master (R. 80), who filed an Interim Report (R. 27) holding that the entire property of the railroad is *in custodia legis*, and that the Bankruptcy Court is the proper court to determine the validity and amount of the tax claims of the State and incidental liens and that the Trustees' petition for adjudication of liens should not be dismissed.

Objections were made by the State to this report (R. 129), and the District Court after a hearing made Order No. 271 (R. 138) confirming the Interim Report of the Special Master. The Attorney General appealed from this order (R. 141). Before the case was heard in the Circuit Court of Appeals the Attorney General of the State filed in the Circuit Court of Appeals a petition for writ of prohibition (R. 10) praying that the Circuit Court of Appeals forbid the District Court and Special Master from making any adjudication in connection with the tax debt liens of the State.

The Circuit Court of Appeals in its opinion (R. 148) denied the petition for a writ of prohibition and in reversing Order No. 271 of the District Court said:

> "the only matters left open for the Bankruptcy Court to pass upon are: (1) Mathematical error in the computation of the amount of the tax, or (2) Legal error in its assessment. • • •
>
> "In No. 8889 Order No. 271 of the District Court is reversed. This disposes of the entire matter before us. The application for a writ of prohibition in No. 8861 is therefore dismissed, without costs to either party as against the other."

This, when read with the judgment reversing Order No. 271, was an instruction that the amount of the State's claim for taxes and penalties and the lien asserted were no longer open to further litigation.

The trustee filed a petition for rehearing (R. 170) asserting that the court had misconceived the questions involved on the appeal and had determined the matter as though only the assessments were involved, whereas the

question actually involved was solely as to *the jurisdiction of the Bankruptcy Court over the claims of the State of New Jersey for taxes and interest and penalties and all matters in relation thereto.* The trustees had waived all questions as to the assessments of such taxes. The petition for rehearing was denied (R. 186) and this court granted certiorari.

It seems important to define the status of the State's claims for taxes and interest (a) at the commencement of the reorganization proceedings, (b) their treatment during the reorganization proceedings, and (c) their present status.

Although, as will appear below, the State formally filed its claims in the reorganization proceeding (R. 64) and prayed for their allowance "in the order of priority specified in Sec. 64 11 U. S. C. A. 104 of the Bankruptcy Law", the position of the present Attorney General is that these claims being represented "by liens that were fixed prior to bankruptcy", are outside the jurisdiction of the Bankruptcy Court.

B. Status of the State's Claims on October 30, 1939

When debtor's petition for reorganization was filed on October 30, 1939, the status of the claims of the State for taxes for the years 1932 to 1939, inclusive, was as follows:

1932 and 1933 Assessments, Taxes and Interest

The 1932 and 1933 assessments had been reviewed on appeal and sustained by the State Board of Tax Appeals, whose judgment in the 1933 case had been reviewed and affirmed by the State Supreme Court. Bills in equity were filed in the United States District Court to set aside the assessments for 1932 and 1933 on the ground of unjust discrimination, in which the debtor was unsuccessful. (See detailed statement annexed to State's claim (R. 70).)

After all this litigation was determined in favor of the State, its Attorney General gave notice on October 20,

1939 that, pursuant to N. J. R. S. 54:28-1 et seq. he would, on November 2, 1939, apply to the New Jersey Supreme Court for the entry of a summary judgment for unpaid taxes for the years 1932 and 1933 amounting to $3,979,185, plus penalties* to November 2, 1939 amounting to $3,250,429, or a total of $7,229,614, and for the appointment of a Master to sell debtor's property under said judgment. This notice, in view of the debtor's inability to make the payments demanded, was the immediate cause of the filing of debtor's petition for reorganization on October 30, 1939 (R. 192). The trustees and bondholders filed objections to the State's claims for these taxes in the Bankruptcy Court, alleging among others various constitutional grounds (R. 73, 74, Pars. I and J).

1934, 1935 and 1936 Assessments, Taxes and Interest

The 1934, 1935 and 1936 assessments of taxes against the debtor had been reviewed on appeal to and sustained by the State Board of Tax Appeals.

After exhausting their administrative remedy in the State Tribunals debtor and a number of other railroads secured injunctions in the United States District Court pendente lite restraining the collection of said taxes. After an exhaustive trial Judge Forman in *Central Railroad of New Jersey* v. *Martin*, 30 Fed. Supp. 41, filed his opinion on November 1, 1939, two days after the debtor filed its petition for reorganization, holding that said taxes and similar taxes of numerous other railroads had been assessed "in plain violation of established principles that govern property valuation", and that "the prayers of the plaintiffs for injunctions to restrain the collection of taxes will be granted until such time as the taxing authorities of New Jersey revalue the property in accordance with the

* of 1% per month, R. S. 54:27-4. The law of the Third Circuit at that time was that this was a penalty, and not allowable under Sec. 57 J. *In re Pressed Steel Car Co.*, 100 F. 2d, 147.

views herein expressed". Subsequently, a decree was entered restraining the collection of more than 70% of the taxes assessed.

On an appeal by the State, in which the State failed and neglected to join the trustees as parties respondent, the Circuit Court of Appeals for the Third Circuit, on November 27, 1940, reversed the District Court (*Central Railroad et al.* v. *Martin,* 115 Fed. (2d) 968; cert. den. 313 U. S. 568). (See, also statement annexed to State's Claim R. 70.)

1937, 1938 and 1939 Assessments, Taxes and Interest

When the debtor filed its petition for reorganization it had appeals pending before the State Board of Tax Appeals from assessments for the years 1937, 1938 and 1939. The Board did not file its decision affirming the taxes for 1937 and 1938 until May 13, 1941 (*Central Railroad Company of New Jersey Appeal,* 19 N. J. Misc. 427). Under the provisions of the New Jersey Statute, R. S. 54:29a-36 debtor had until August 13, 1941 (90 days) to apply to the New Jersey Supreme Court for a writ of certiorari to review said decision. On August 11, 1941 the trustees waived this right as a condition of accepting the offer of compromise contained in the Tax Settlement Act hereinafter referred to.

Debtor's appeal from the taxes assessed in 1939 was duly taken but had not been acted upon when the trustees, with court approval, discontinued the appeal and accepted the provisions of the Tax Settlement Act as hereafter mentioned. (See Statement annexed to State's Claim for Taxes, R. 71.)

Accordingly, when debtor's petition for reorganization was filed, the amount of its liability for taxes and interest for each of the years 1932 to 1939, inclusive, was in issue and being litigated either before the State Board of Tax

Appeals or in the Federal Courts, and that the amount of the State's liens for each of said tax years was wholly unsettled.

C. Proceedings on the State's Claim for Taxes and Interest Penalties in the Reorganization Proceedings

Two days after the filing of the petition for reorganization the District Court, on November 1, 1939, entered an order restraining the Attorney General from continuing the proceedings that he had started for the entry of judgment in the New Jersey Supreme Court for taxes levied against the debtor by the State for the years 1932 and 1933 and for interest thereon (R. 195).

On December 7, 1939 the debtor filed a petition with the court for instructions whether it should prosecute its appeal before the State Board of Tax Appeals from the 1939 tax assessment and whether pending the filing and allowance of claims by creditors it should make a payment on account of 1939 taxes. An affidavit of the Comptroller of the debtor filed with the court and verified December 12, 1939, showed that the total tax claims of the State for the years 1932 to 1939, inclusive, not including penalties or interest, aggregated $15,067,002 (R. 200), while the total estimated liquid resources of the railroad were $7,097,458, or, about $8,000,000 less than the principal amount of the taxes, not including penalties or interest (R. 199).

On the debtor's petition aforesaid Judge Fake issued an order requiring the Attorney General of the State and all others in interest to show cause why an order should not be entered instructing the debtor whether it should pay any part of the 1939 taxes (R. 201). In response to this order to show cause Mr. Solan, Assistant to the

Attorney General of the State, appeared in court on December 13, 1939 (R. 202) and asked the court to make "an order that the debtor pay out of the funds in hand • • • at least sixty percentum of the taxes levied against the property for the year 1939" (R. 206).

On December 26, 1939 an order was made directing the debtor to pay to the State $2,049,553.23 on account of the taxes claimed to be assessed against its property by the State for 1939 (R. 220). This amount (60%) was paid out of the general funds of the debtor in the hands of the trustees to which the State's alleged lien did not apply.

On June 12, 1940 the trustees filed a petition for an order authorizing them to pay out of the funds of the debtor $100,000 per month on account of the State's taxes for 1932 and 1933 (R. 222). The Attorney General, Mr. Wilentz, appeared in court on the filing of this petition and asked the court to make an order for more substantial payments than $100,000 per month if the debtor was financially able (R. 227). The following day Judge Walker signed an order authorizing the trustees to pay to the State six monthly instalments of $150,000 each beginning July 1, 1940, on account of the taxes for the years 1932 and 1933 (R. 230). These payments likewise were made out of the general assets in the hands of the trustees.

On November 25, 1940 the trustees filed a petition for instructions as to what part of the taxes assessed against the debtor and subsidiaries for the year 1940 they should pay (R. 236). The Attorney General filed an answer to this petition praying "that the trustees of the debtor be directed to pay immediately to the Treasurer of the State of New Jersey • • • the full amount of the taxes levied for 1940" (R. 238). After hearing, the reorganization court directed that $2,030,742.78 be paid to the State on account of taxes assessed for the year 1940 (R. 240). This was 60% of the taxes assessed for 1940.

As required by Section 77(c)(7) of the Bankruptcy Act, 11 U. S. C. A. (c) (7) the Bankruptcy Court on pe-

tition of the trustees made an order on October 7, 1940 requiring claims of all creditors of the debtor to be filed on or before December 31, 1940 (R. 232). In compliance with this order the State of New Jersey as claimant, by its Comptroller, a constitutional officer, on December 15, 1940 filed its proof of claim demanding payment of the *full balance of taxes and interest at 12% per annum* claimed to be due by the State from the debtor for the years 1932 to 1939, inclusive (R. 64). The total amount of claim was stated to be:

> "$12,117,450.68 taxes, plus interest thereon in the sum of $7,732,339.53, plus additional interest on said unpaid taxes from December 1, 1940 to date of payment" (R. 64).

Partial payments theretofore made were stated as aggregating $18,128,962.82, as shown in detail on Schedules A and B attached (R. 65). The schedules appear on pages 68 and 69 and list the first-class and second-class railroad taxes year by year, with the payments made on account in each year, and the taxes due with interest at 1% per month to December 1, 1940.

This proof of claim was in the form required by Section 57, 11 U. S. C. A. 93 of the Bankruptcy Act, and paragraph 10 reads as follows:

> "(10) Lien, priority or preferential classification, if any, claimed for the claim, or any part thereof, the reasons therefor and full statement of the facts respecting same:
>
> "The statute of New Jersey provides that these taxes shall be a lien paramount to all other liens upon all the lands and tangible property and franchises of the company in this State (Section 9, Chapter 208, P. L. 1888, as amended and supplemented; Section 54:27-4, Revised Statutes). The

lien shall take effect on June 1 of the year in which the tax is payable."

While the present Attorney General now asserts that this proof of claim amounted merely to a notice that "the State had liens for taxes that were outside the jurisdiction of the court, and to lay the basis for the making by the Comptroller of a claim on behalf of the State for any deficit that might arise in the event that the property of the debtor should not be sufficient to satisfy the tax lien", the claim was not "for any deficit that might arise" but was expressly for "unpaid balances of taxes assessed and levied by the State of New Jersey upon property and franchises of the debtor for the years 1932 to 1939, both inclusive" plus interest of 1% per month (R. 64).

In view of the State's present contention that all questions as to the amount and legality of taxes were *res judicata* when the reorganization proceeding began, and that the formal filing of the proof of claim did not in fact invoke the jurisdiction of the Bankruptcy Court but was merely a notice of a perfected lien, it is of interest to note that on December 15, 1940, when the proof of claim demanding payment aforesaid was filed, the law of the Circuit Court was that the 12% interest claimed by the State amounted to a penalty and was not allowable under Section 57(j) 11 U. S. C. A. 93(j) of the Bankruptcy Act. (See footnote, p. 6, *supra*.)

It is further interesting to note that at the time the claim was filed the decision of the District Court restraining the collection of more than 70% of the principal amount of taxes assessed for the years 1934, 1935 and 1936 was still pending on appeal before the Third Circuit (see 115 Fed. (2d) 968, rehearing denied Jan. 24, 1941). Furthermore appeals from the taxes assessed for the years 1937, 1938, 1939 and 1940 were still pending before the State Board of Tax Appeals.

The trustees filed detailed objections to the allowance of the State's proof of claim on February 27, 1941 (R. 71), contending, among other things, that the property of the debtor was grossly overvalued; that each structure was valued independently at cost, less depreciation, and in complete disregard of its market value or true value* as part of an operating railroad property; that the real and personal property of the debtor and other railroads was assessed in excess of true value while other real property in the State was intentionally and systematically assessed at not more than 60% of value, and personal property of taxpayers other than railroads was systematically and intentionally omitted from taxation, and when taxed was assessed at less than half the ascertainable value (R. 71). Detailed objections were also filed as to the allowance of 1% interest per month as claimed (R. 76).

On March 26, 1941 the State, by its former Attorney General, filed in the Bankruptcy Court a "Reply of Claimant State of New Jersey to Trustees' Objections to Tax Claims" (R. 242), which, after denying the allegations in the State's objections, asserted:

> "6. Said unpaid taxes and interest are legally due and owing to claimant and are required by law to be paid by the trustees, in advance of the payment of other claims, *in the order of priority specified in Section 64 of the bankruptcy law* (11 U. S. C. A., sec. 104, p. 123)" (R. 244).**

And concluded with the prayer:

> "Wherefore claimant prays for the dismissal of said objections, and each of them, and for allowance

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* The New Jersey Constitution provides, Art. 4, Sec. 7, Par. 12:

"Property shall be assessed for taxes under general laws, and by uniform rules, according to its true value."

** Italics throughout this brief are supplied.

of the full amount of each of said claims and interest as set forth in Schedule (A) attached thereto, respectively, together with interests on said taxes, respectively, at the rate of one percent per month and after December 1st, 1940."

In the record we have printed only claim No. 38 of the State against the debtor.

The State also filed the following claims against subsidiaries of the debtor which are still in issue:

Claim No. 34, $10,368.88 against Ogden Mine Railway Co.

Claim No. 36, $22,939.09 against Dover & Rockaway Railroad Company.

Since the issues on this appeal are raised and can be adequately dealt with as to Claim No. 38 against the debtor, we are not complicating the case with reference to the other claims, aforesaid, which are in the same basket. The details of these claims against subsidiaries with the amount of the balance claimed (erroneously described as "Amount of Levy") and dates of payment on account appear in the Record at pages 110-111 and 87-89.

On April 1, 1941, on notice to all parties including the State, the Bankruptcy Court entered Order No. 93 referring all contested claims, including the tax claims of the State, to a Special Master for hearing and report (R. 234). There had been an earlier reference in Order No. 88 to the same Special Master referring the claims on coupons on debtor's mortgage bonds to him, and he was by Order No. 93 permitted to combine his reports on the mortgage bonds and other claims, including the State's tax claims, in one report (R. 236).

1. The Railroad Tax Settlement Act of 1941 and the Events that Caused the Legislature to Enact It

a. The Factors and Events that Induced the Settlement Acts

On December 1, 1940 taxes upon property used for railroad purposes that had been accumulating against seven of the larger railroad companies since and including 1932 were in litigation in an amount approximating $34,000,000. Interest accruals claimed thereon amounted to an additional $24,000,000.

These taxes were assessed against seven major operating railroads but there was a large number of local proprietary railroad companies whose properties were used and operated as a part of said major interstate railroad systems. Four of these proprietary companies were embraced in The Central Railroad Company of New Jersey System; eleven in the Delaware, Lackawanna & Western System; fifteen or more in the Erie or Susquehanna Systems; four in the Lehigh Valley System; three in the New York Central System and four in the Reading System. There was a probability that if there were actual sales of the railroad property pursuant to the mandatory procedures of the Tax Statutes (R. S. 54:28-1) there would be a disintegration of the several railroad systems into their numerous component parts.

At this time it was the view of many sober minded people that notwithstanding the existence of newer methods of transportation the railroads were essential to industry and to society generally, and were urgently needed as factors in the war that already had partly gripped the country at the time of the passage of the first of the Railroad Tax Settlement Acts, and obviously would, as it soon did in fact, involve it as an actual participant. Those matters were all of common knowledge and served to emphasize the need in the interests of the

State for a certain and speedy method of collecting tax arrearages.

Governor Moore in a message to the Legislature in November, 1933 relating to the method of taxing railroad properties and the then existing litigations, urged that:

> "a committee representative of the Legislature and of the State be appointed that will with diligence and dispatch undertake in a painstaking and systematic manner the study of this question for the purpose of reaching some intelligent conclusion as to the course of action necessary to be taken by the Legislature for the modification or clarification of this (railroad tax) law. While it may be impossible to sustain railroad assessments to the amount which they have been assessed in recent years, it is entirely probable that some basis of rate and method of assessment may be arrived at which we can sustain in the courts, and thus end the interminable controversies which we now appear to be engaged in."

A similar message was sent to the Legislature by Governor Moore in 1934.

On January 14, 1936 Governor Hoffman in his inaugural address reminded the Legislature that the solution of the railroad tax problem was a legislative duty.

When Governor Edison took office about January 1, 1941 the unpaid balances claimed by the State for taxes and interest aggregated approximately $60,000,000. Governor Edison appointed a committee of eminent and qualified citizens, among them the Director of Princeton Surveys of Princeton University, to investigate the facts, study the questions involved and advise a solution. That committee, on February 22, 1941, made a comprehensive and widely circulated report which went into detailed facts and figures and the significance thereof. It was an economic rather than a legalistic study. The report made

certain recommendations, the first of which was that there be legislative action to permit "the payment of all railroad tax delinquencies in full, over a designated period of years, without penalty".

In the light of that report the Legislature appointed a joint legislative committee, which reported back to the two Houses a series of four recommended bills stated to be "the same bills with minor changes, prepared for the Governor's special committee by the Princeton Group and submitted" to the Legislative Committee "by Governor Edison, with his approval and recommendation". And the Legislative Committee added further that "The Princeton Surveys have vouched for the complete integrity of the research work upon which this program is based and issued a public statement to the effect that this legislation is sound and workable, and in the best interests of the people of the State".

The delinquencies had over a period of eight or nine years "run into a vast figure by reason of which the State and Municipal finances were greatly depleted. Some of the railroads had gone into insolvency, the end of which was unforseeable. Others might do so."

All of the above facts are from the very able dissenting opinion of Justice, now Chief Justice, Case in *Wilentz* v. *Hendrickson*, 135 N. J. Eq. 261 et seq.

In addition see the statement of purposes of the Legislature contained in Sec. 15 of the 1942 Settlement Act, Chapter 241, P. L. 1942, appendix annexed.

b. The 1941 Railroad Tax Settlement Act

The New Jersey Legislature passed Chapters 290 and 291, P. L. 1941, both of which were approved and became effective July 22, 1941.

Chapter 290, entitled:

> "An act relating to the collection of certain delinquent taxes upon railroad companies"

authorized in Section 1 the State Treasurer to accept without interest penalties, instalment payments of the full principal amount of property taxes upon railroad companies which were due on or before December 1, 1940 and remained unpaid on the effective date of the Act, but not unless and until the delinquent taxpayer shall have complied with the requirements of Sections 7 and 8.

Section 7 provided that any railroad, or the trustee or trustees thereof, might enter upon the execution of an instalment payment plan authorized by the Act by duly executing and filing with the State Comptroller a written undertaking in such form as the Attorney General shall prescribe for the payment of the total amount of delinquent taxes owed by the railroad or system, and paying into the State Treasury an amount not less than the first annual instalment together with interest on the unpaid balance computed in accordance with the statute.

Section 8 provided that the first payment tendered pursuant to this Act shall be accompanied by a waiver of any and all rights to contest the legality or amount of any assessment made prior to December 1, 1941, together with stipulations, consents or other papers for the discontinuance and dismissal of all suits, actions and proceedings pending in any court or before the State Board of Tax Appeals concerning such assessments, all in such form as the Attorney General may require.

In Section 9 it was provided that the Attorney General be authorized and directed to execute in the name of the State any and all consents to a plan or plans of reorganization of a railroad corporation under federal bankruptcy or other laws to the extent that such plan provides for payments to the State on claims for taxes in accordance with the provisions of the Act.

Section 4 of this Act provided that all interest penalties upon taxes paid pursuant to this Act shall be abated and cancelled, except that in addition to instalment payments interest at the rate of 3% per annum shall be paid

annually upon the balance of delinquent taxes remaining unpaid from and after December 1, 1940.

Section 5 provided that the liens of the State for taxes and interest penalties for each year in which delinquent taxes are payable shall be fully satisfied and discharged, in the order in which such taxes accrued, when and as principal payments on account thereof equal or exceed the full principal amount delinquent for any tax year and interest upon any and all unpaid balances has been paid in full.

Section 6 provided that the remedies of the State for the collection of delinquent taxes shall not be enforced against any taxpayer which enters upon the execution of an instalment payment plan in the manner provided by Section 7, so long as instalment payments and interest upon the unpaid balances continue to be paid on or before the respective due dates.

(See true copy of Chapter 290 in appendix annexed.)

Chapter 291, P. L. 1941, was a new act relating to the taxation of railroads and repealing all of the prior railroad tax laws (see P. L. 1941, Chap. 291, p. 773).

Prior to the enactment of Chapter 291, P. L. 1941, taxes were assessed on all the real property of a railroad outside of the main stem at local rates, which varied in each municipality. Property on the main stem and tangible personal property of railroads was assessed by the State Tax Commissioner at the average of the rates of all municipalities through which the main stem ran.

Under Chapter 291, P. L. 1941, two taxes were laid: (1) on all property used for railroad purposes at the rate of 3% upon the true value (Section 7), and (2) a franchise excise tax upon the net railway operating income of each system for each year (Section 13).

Furthermore, in the 1941 Act the Legislature attempted to both extend and enlarge the alleged lien of

the State. Under the former law, R. S. 54:27-4 under which the taxes were assessed, the statute imposed a lien

> "upon all the *lands and tangible property and franchises of the company in this State.* The liens shall take effect on *June 1st* of the year in which the tax is payable."

In the new tax act, Chapter 291, P. L. 1941, R. S. 54:29a-54 Pamphlet, it was provided:

> "The taxes imposed by this act or *heretofore imposed pursuant to any act* for the taxation of property used for railroad and canal purposes shall be and remain a lien paramount to all other liens *upon the revenues and all the real and personal property owned, used or controlled by the taxpayer within this State. The lien shall take effect as of the 1st day of the year* in which the tax is payable."

Exact copies of the pertinent provisions of the old and new acts are in the appendix annexed.

On August 8, 1941, debtor's trustees filed in the District Court a petition for authority to compromise pursuant to Chapter 290, P. L. 1941, the controverted taxes levied by the State of New Jersey for the years 1932 to 1940, inclusive, on properties of the debtor and its subsidiaries (R. 246). In this petition the trustees reported that after the payments on account that had been authorized by the court there remained unpaid by the debtor on July 22, 1941 the following principal amount of taxes claimed by the State to be due;—

By Central Railroad Company of New Jersey	$ 13,438,669.19
By The Dover & Rockaway Railroad Company	15,185.44
By The Ogden Mine Railroad Company	5,776.23
TOTAL	$ 13,459,630.86

Trustees stated that they believed they should execute and file the undertaking provided for in Section 7 of the Act and should pay on behalf of the debtor the first annual instalment of taxes, together with stipulations, consents and other papers for the discontinuance and dismissal of all suits, actions and proceedings pending in any court or before the Board of Tax Appeals concerning said assessments, and they prayed that the court might order and direct them to compromise the total of delinquent taxes levied by the State, and that the trustees might be authorized to execute any undertakings, waivers, etc., required under the provisions of the Railroad Tax Settlement Act, payments to be made with interest at 3% from December 1, 1940 as required by the Act. The forms of undertakings and waiver annexed to the petition are printed in the Record, pages 250-252.

On the same day Judge Fake signed Order No. 123 authorizing the trustees to settle and compromise and pay the delinquent taxes levied by the State aforesaid, and authorizing them to execute, file and tender the undertaking and waiver substantially in the form annexed to the petition, "with such other undertakings, waivers, stipulations, consents and papers as may be prescribed or required to carry out the provisions of Chapter 290, P. L. 1941, etc." (R. 253).

The trustees, on August 11, 1941, on the authority of the order of the court of August 8, 1941, which was an acceptance of the offer of compromise contained in the State's statute aforesaid, filed with and delivered to the appropriate officers of the State all of the documents and payments required of them and subsidiary companies to comply with said offer of compromise; the trustees discontinued all of the litigation as to 1934, 1935 and 1936 taxes; they refrained from applying to the State Supreme Court for a writ of certiorari to review the decision of the State Tax Board as to the 1937 and 1938 taxes, which might have been applied for at any time prior to August

13, 1941 (as shown on page 7 hereof); and consented to the discontinuance of the pending appeals before the State Tax Board as to taxes assessed for the years 1939, 1940 and 1941.

The Attorney General made no objection to the form or sufficiency of the settlement papers, but arbitrarily refused to pass on said forms.* The State Treasurer and State Comptroller, however, have never returned the undertaking of the trustees to pay as required by the Settlement Act, nor the waivers and discontinuances, and did not return the certified checks of the trustees until May 2, 1946, when they were returned at the trustees' request, without prejudice, as provided in Order No. 333, which will be described hereafter (p. 35 hereof).

After the trustees had delivered to the appropriate officers of the State all the documents and payments required for full compliance by the debtor and subsidiary companies with the Railroad Tax Settlement Act of 1941,** David T. Wilentz, then Attorney General of New Jersey, on Sept. 4, 1941 instituted a civil information suit in the Court of Chancery of New Jersey against Robert T. Hendrickson, State Treasurer, and prayed an injunction against the State Treasurer from carrying out the provisions of Chapter 291, P. L. 1941, on the allegation that said statute was in violation of Article I, Par. 20 of the New Jersey Constitution, which provides that:

> "No donation of land or appropriation of money shall be made by the State or any municipal corporation to or for the use of any society, association or corporation whatever."

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* The Attorney General refused to perform this ministerial act, although it has never been suggested that the documents executed and filed by the trustees were not effective, and completely binding on the trustees.

** The Act set up a formula for determining over what number of years the taxes might be paid in annual instalments. Under this formula debtor's taxes were payable over a period of 20 years.

No other party was named or appeared in said suit. No application was made to the Bankruptcy Court to make the trustees of the debtor parties to this suit nor was the State Comptroller made a party, although he acted for the State in signing and verifying the proofs of claim that had been filed in the Bankruptcy Court and under the Settlement Act the "undertaking" prescribed was required to be filed with the Comptroller (R. 50, par. 16).

As December 1, 1941 approached, the date on which taxes levied for the year 1941 became payable, the trustees, in view of the action of the Attorney General in attacking the constitutionality of the Settlement Act and in view of the further fact that the trustees in accepting the offer of settlement therein contained had waived an appeal from the 1941 assessment which had been filed with the State Tax Board on instructions of the Bankruptcy Court before the Settlement Act was complied with, filed a petition with the court for instructions whether under all of the circumstances they should pay the taxes as levied for the year 1941 (R. 268).

Hearing on this petition was held before Judge Fake in the reorganization court on November 24, 1941 (the State not being represented although it had notice), and on the same day the court signed Order No. 135 finding, adjudicating and decreeing that the Trustees had taken all steps necessary on behalf of the Debtor's Estate to comply with the provisions of the Settlement Act and in view of such compliance authorized the Trustees to pay the State in full, on or before December 1, 1941, the taxes assessed against the Debtor and its subsidiaries for 1941.

The Attorney General did not object to or appeal from said Order 135 but on the contrary the State accepted the trustees' check for the 1941 taxes which it directed to be paid.

2. The Tax Settlement Act of 1942

The information suit which Attorney General Wilentz had filed in the Court of Chancery against the State Treasurer was defended by the State Treasurer through special counsel employed by the State, and the Legislature appropriated $50,000 for the defense of this action (see Chap. 391, P. L. 1941, approved Dec. 23, 1941).

The next (1942) Legislature passed Chapter 241, P. L. 1942, approved by the Governor to take effect immediately (May 21, 1942). This law amended the title of Chapter 290, P. L. 1941, as well as the body of that law (a copy is annexed hereto as part of the appendix). This act followed closely the terms of the 1941 Act, but prescribed the exact form of the settlement papers and left no ministerial duties to the Attorney General. Among other things this Act provided, amending Sec. 1 of the 1941 law:

> "Any railroad taxpayer desiring to accept the provisions of this Act shall, on or before June fifteenth, One Thousand Nine Hundred and Forty-two, file with the State Treasurer the acceptance document required by this Act, providing for the payment in full of the principal amount of all of its unpaid taxes for the tax years involved at the times and in the manner provided by this Act, and waiving any and all rights to contest the legality or amount of any assessment on its property used for railroad purposes made prior to December first, One Thousand Nine Hundred and Forty-one, pursuant to the applicable tax acts, and of any assessment heretofore or *hereafter* made for the tax year One Thousand Nine Hundred and Forty-one; and shall also file with the State Treasurer a written consent to the discontinuance and dismissal of any and all suits, actions and proceedings pending in any court or before the State Board of Tax Appeals

respecting any such assessments; and shall also at the same time pay to the State Treasurer the initial payment provided for by this Act. The State Treasurer is hereby authorized and required to accept payment of such unpaid taxes when made in accordance with the terms of this Act."

The significance of the phrase requiring the railroad taxpayer accepting the provisions of the Act to pay "any assessment heretofore or *hereafter* made for the tax year One Thousand Nine Hundred and Forty-one" in the above section, is due to the fact that Chapter 169, P. L. 1942, was approved by the Governor May 8, 1942 and took effect immediately. This law amended the Railroad Tax Act of 1941 (P. L. 1941, Chap. 291), and imposed an additional retroactive franchise tax on the debtor for 1941 in the amount of $239,748.80 (See P. L. 1942, p. 516, Sec. 4 amending Sec. 73 of the Tax Act of 1941).

The amended Tax Settlement Act of 1942 (Chapter 241) further provided in Section 4, amending Section 3 of the 1941 Settlement Act:

"The initial payment to be made under this Act shall be made on or before June fifteenth, One Thousand Nine Hundred and Forty-two, and shall be an amount not less than the first annual instalment computed as herein provided."

It also provided:

"All such unpaid taxes shall bear interest at the rate of three percent. (3%) per annum to be calculated from and after December first, One Thousand Nine Hundred and Forty. The initial payment shall include such interest to the date of such payment and each subsequent payment shall include interest at such rate on the unpaid balance of taxes calculated from the date of the next preceding instalment payment."

This latter provision required the trustees to make an additional interest payment on or before June 15th in an amount exceeding $340,000 upon the entire principal of taxes claimed by the State as of December 1, 1940, without deducting therefrom the first instalment of principal tendered under Order No. 123 of August 8, 1941.

On May 21, 1942, the day on which Chapter 241, P. L. 1942 was approved, the Attorney General filed a supplemental civil information in the Court of Chancery challenging the constitutionality of said Chapter 241 on the same grounds as were alleged in his original information (R. 276, par. 15).

The trustees had only the period between May 21, 1942, when Chapter 241, P. L. 1942 was approved by the Governor, and June 15, 1942 (Section 4) to secure court approval of the acceptance of the settlement contained in Chapter 241 and to comply therewith.

The trustees accordingly filed their petition, verified on June 2, 1942 (R. 270), for instructions whether they should comply with the 1942 Act, which recited the filing of the State's Claim No. 38 for taxes by the Comptroller on December 10, 1940; the reference of said claim by Order No. 93 to a Special Master; the order the court had made on August 8, 1941, (No. 123) authorizing the trustees to compromise and pay the principal amount of the State's claims pursuant to the terms of Chapter 290, P. L. 1941, and the trustees' compliance therewith; and the Order No. 135 finding that the trustees had complied with the terms of the offer of compromise contained in the Settlement Act and directing petitioners to pay in full the taxes assessed against the debtor by the State for 1941.

The trustees' petition also recited the passage by the Legislature of Chapter 169, P. L. 1942, amending the franchise tax payable by railroads under the 1941 law, and alleged that the taxes payable by certain other railroads for the year 1941 were thereby reduced but that the franchise taxes against the debtor were retroactively in-

creased by the 1942 Act for the year 1941 in the amount of $239,748.80.

The court was advised in said petition that new and additional acceptance documents and waivers were required by the 1942 Act (Chapter 241) and that the trustees would be required to waive any and all rights to contest the legality of the additional assessment retroactively made against the debtor for 1941. The court was further advised that grave doubt existed as to the legality and constitutionality of the retroactive levy and assessment against the debtor for the year 1941 above mentioned, and the reasons therefor.

On the filing of this petition the District Court made an order (No. 161) requiring the Attorney General, the Comptroller and the Treasurer of the State and all parties, to show cause at a hearing to be held June 8, 1942 why the amount of the tax claim of the State against the debtor for 1932 to 1939 should not be fixed and adjudicated at the principal amount of taxes alleged to be due, payable at the times, with interest and upon the terms and conditions prescribed by Chapter 241, P. L. 1942, and why the interest and penalties as claimed by the State should not be disallowed and dismissed (R. 278).

On the return of this order to show cause and after hearing the Attorney General, the Comptroller and counsel for the State Treasurer and other parties, the court made its Order No. 163 allowing the State's tax claim for the amount of the principal of the taxes as shown by Claim No. 38 of the State, and instructing and directing the trustees, on or before June 15, 1942, to comply with the provisions of Chapter 241, P. L. 1942, and it adjudged that upon full compliance as aforesaid the claims of the State will have been fully satisfied and discharged.

The trustees thereupon fully complied in all respects with Chapter 241 not only as to taxes assessed by the State against the debtor for 1932 to 1940 inclusive, but also as to all taxes claimed from subsidiaries of the debtor,

and waived any and all right to contest the legality or amount of said retroactive franchise tax in the amount of $239,748.80 for 1941, which the trustees paid in good faith and without contest, and for the recovery whereof the laws of the State provide no right or remedy. They also paid, as required, said $340,000 of additional interest, and also filed and delivered to the appropriate State Officers all of the documents and papers required for full compliance with the terms of Chapter 241 by affiliated companies (R. 54, par. 21).

It thus appears that the Trustees, on orders of the District Court, fully accepted the offers of compromise made by the State in the form of Chapter 290, P. L. 1941 and Chapter 241, P. L. 1942 and complied therewith in all respects. After thus complying all pending appeals and all litigation wherein taxes assessed by the State for the years 1934 down to 1941 were being litigated, were discontinued.

It is to be noted that the trustees' compliance with the 1941 statute was fully completed before the Attorney General filed his information suit in the Court of Chancery.

The Attorney General appealed to the United States Circuit Court of Appeals from Order No. 163 on the ground, among others, that the District Court determined the amount of taxes due the state on its claims, which the State contended was a determination of the constitutionality of the Tax Settlement Acts, although the District Court at the Attorney General's request, in the order expressly disclaimed passing upon the validity of the acts.

The Circuit Court of Appeals, however, in *In re Central Railroad Company of N. J.*, 136 Fed. (2d) 632 (rehearing denied June 15, 1942; cert. den. 320 U. S. 805) reversed so much of said order as purported to determine the amount of tax payable to the State and concluded:

> "One final point must be noticed. Order No. 163 authorized the trustees of the debtor to comply with

the Tax Settlement Acts by executing and filing the documents and making the payments therein required. Since the law directed that these steps be taken on or before June 15, 1942, it is vitally important to the debtor in case the constitutionality of the Tax Settlement Acts is ultimately sustained, that the tenders made by the trustees prior to that date pursuant to the directions of Order No. 163 be not invalidated by the reversal of that order. Accordingly so much of paragraphs 6 and 7 of Order No. 163 as authorizes the trustees to comply with the requirements of the Tax Settlement Acts will not be disturbed."

The cause was remanded to the District Court

"with directions to the District Court to await the determination by the Court of Chancery of the State of New Jersey of the constitutionality of the Railroad Tax Settlement Acts, unless it finds that delay which may be harmful to the debtor and its creditors may result, in which event it may proceed itself to hear and decide the constitutional issue."*

We assume that this court in denying the trustees' petition for a writ of certiorari, to review said action of the Circuit Court, 320 U. S. 805, did so because it considered it best to await the decision of the State Courts, for if they should determine the Settlement Acts were constitutional the controversy would be at an end. Moreover the order of the Circuit Court of Appeals was not a final order.

* It will be observed that the Circuit Court thus concedes the jurisdiction of the Bankruptcy Court to determine this question but it obviously did not seriously consider that court's paramount power to determine the effect of the State's compromise offer to the Federal Court and the acceptance thereof.

a. The decision of the State Courts

On September 28, 1943, more than a year after the trustees had complied with the amended Settlement Act and had under the direction of the Bankruptcy Court in good faith waived all their rights further to contest the taxes claimed by the State for the years 1934 to 1941 inclusive, and had paid without contest the retroactive franchise tax of $239,748.80 for the year 1941 and the additional and accelerated interest aggregating $340,000 above mentioned, the Court of Chancery entered a decree in *Wilentz* v. *Hendrickson,* 133 N. J. Eq. 447. The Vice-Chancellor in his opinion held that the Settlement Acts violated Art. I, Par. 20 of the New Jersey Constitution aforementioned and enjoined the State Treasurer from complying therewith.

The State Treasurer appealed from this decision to the New Jersey Court of Errors and Appeals, which, on June 22, 1944, affirmed the decree of the Vice-Chancellor on the ground that the remission, cancellation and abatement of delinquent interest due from the railroads was not supported by legal, equitable or moral consideration, and that accordingly the amended Settlement Act amounted to an appropriation of money for the railroad corporations in violation of Art. I, Par. 20 of the State Constitution [135 N. J. Eq. 244].

It is to be observed from the opinion in *Wilentz* v. *Hendrickson* that the cause was submitted to the Vice-Chancellor in the controversy between the Attorney General and the State Treasurer on a stipulation of facts (135 N. J. Eq. at p. 250). There were no other parties to this action than the State officers. The opinion of the Court of Errors and Appeals said:

> "Is the remission, cancellation and abatement of the tax debt (delinquent interest) supported by a legal, equitable or moral consideration? The learned

Vice Chancellor answered that question in the negative. Here, too, we are entirely satisfied that the proofs and authorities upon which he relied support his answer."

The proofs consisted of the facts stipulated between the State Attorney General and the State Treasurer. They were not and could not have been the facts peculiar to the situation of the debtor.

b. The Trustees' Petition for Adjudication of the State's Tax Claims on which the Issues here presented were raised

On August 14, 1944, within two months after the decision of the Court of Errors and Appeals in *Wilentz* v. *Hendrickson, supra,* the trustees filed in the Bankruptcy Court their "Petition for Adjudication Concerning New Jersey Tax Claims", in which they stated the history of the matter as hereinabove recited, but in less detail, and prayed that the court promptly adjudicate (1) whether petitioners entered into a contract with the State of New Jersey; (2) whether such contract, *i. e.,* compromise, is binding on the parties thereto; (3) whether, if not binding on the State, petitioners are nonetheless bound by the prejudicial actions taken by them; (4) if not binding on the parties thereto, including petitioners, to what extent if at all the proofs of claim of the State of New Jersey should be allowed; (5) what order should in such event be made to restore the equivalent of the *status quo ante* as nearly as may be; and (6) what in such event are the relative rights, claims, liens and priorities of the claimants in the assets of the debtor's estate; and that the court may instruct petitioners whether to make, on or before December 1, 1944, the additional payment on account of the taxes claimed and the additional interest payment required by Chapter 290, P. L. 1941, as amended by Chapter 241, P. L. 1942 (R. 63).

The Attorney General, after being served with a copy of the above petition, filed a special appearance objecting to the jurisdiction of the Bankruptcy Court to entertain said petition on the ground that same constitutes "the maintenance of a suit, claim or demand against the State of New Jersey, by citizens thereof, beyond the judicial power or jurisdiction of any court of the United States to entertain", and prayed that the petition of the trustees shall be "dismissed insofar as same prays for or seeks an adjudication or determination that the claims of the State of New Jersey for taxes and interest thereon are less than such sums as have been assessed against the debtor and the trustees by the duly constituted authorities of the State, or have lawfully accrued, pursuant to the laws of the State, and insofar as the liens of the State for such taxes and interest are sought in any wise to be altered, affected, modified or destroyed by any such adjudication or determination" (R. 79).

The Bankruptcy Court thereupon, by Order No. 250, re-referred the State's tax claims, the trustees' objections thereto, and the State's reply to said objections, the trustees' petition for adjudication and the aforesaid purported special appearance on behalf of the State objecting to the court's jurisdiction to consider the trustees' petition for adjudication of the State's tax claims to Augustus C. Studer, Jr., as Special Master, for hearing and report (R. 80).

The Special Master, after hearing attended by the Attorney General and representatives of bondholders' committees and the trustees, filed an Interim Report on January 17, 1945 (R. 116), in which he found that:

> "the entire property of the railroad is *in custodia legis*, subject, however, to such rights as are given by law to lien-holders. • • • Having custody of the property, the Bankruptcy Court, subject to the limitation expressed in the case of Arkansas Corporation Commission v. Thompson, 313 U. S., p. 132,

which limitation is not now involved, is the proper court to determine the validity and amount of the tax claims of the State of New Jersey and the incidental liens alleged to affect the property in the custody of the court. Isaacs v. Hobbs Tie & T. Co., 282 U. S. p. 734, at p. 738.

"It is the opinion of the Master that the claim of the State to sovereign immunity should be denied and that the petition of the trustees should not be dismissed" (R. 39).

The Attorney General, on January 27, 1945, filed objections to the Interim Report of the Special Master. The court, after argument on February 21, 1945, filed an opinion confirming the opinion of the Special Master (R. 137), and on March 5, 1945 made Order No. 271 confirming the Special Master's Report and overruling the objections of the State (R. 138).

On April 2, 1945, the State by its Attorney General appealed from Order No. 271 to the Circuit Court of Appeals (R. 141).

Prior to the argument of this appeal in the Circuit Court of Appeals, the Attorney General filed in the Circuit Court of Appeals a petition for a writ of prohibition forbidding and preventing the District Judge and Special Master from proceeding with the determination of any matters or the making of any adjudication in connection with the tax debt lien of the State for the years 1932 to 1939 inclusive (R. 10).

In response to the order to show cause issued by the Circuit Court (R. 22), Judge Fake filed an answer which appears at R. 22, in which he said, among other things, that:

"No party to the proceedings has challenged the principle of sovereign immunity or the principle that the custody and title of the Trustees of the debtor

of and to the estate *in custodia legis* is subject to pre-existing liens. However, the added and extended concept advanced on behalf of the State has been challenged, viz., the concept that the estate *in custodia legis* consists of 'only the interest of the Debtor over and above' liens and that 'the court has only that equity which the debtor had immediately prior to the inception of the proceedings.' It is that argument or concept which has been rejected by said Order No. 271 and, as well, the assumption that the quantum, rank and extent of security of a lien claim asserted by a state must be accepted and the lien claim allowed exactly as set forth by the State in its proof of claim and without any scrutiny or determination by the Bankruptcy Court of any issues raised with respect thereto by the Trustees and other parties to the reorganization proceedings" (R. 24, par. 9).

The Circuit Court of Appeals in its opinion referred to the long line of litigation which had for several years occupied the Federal Courts and both the judicial and other branches of the State government (R. 148); it reviewed the State legislation (R. 149); the federal litigation preceding bankruptcy (R. 150); the federal litigation after bankruptcy (R. 151); analyzed the New Jersey method of taxing railroad property during the taxable years (R. 153); the method of reviewing assessments by the State Tax officers (R. 157); considered what the court conceived to be the applicable law (R. 159); and concluded with the statement that the instant problem is brought within the doctrine of the *Arkansas* and *Monongahela* cases, and that "the only matters left open for the Bankruptcy Court to pass upon are: (1) Mathematical error in the computation of the amount of the tax, or (2) Legal error in its assessment."

The last paragraph of the opinion provides that Order No. 271 be reversed and that the application for a writ of prohibition be dismissed (R. 167).

Shortly after this opinion was filed Shelton Pitney, one of the trustees, who had conducted the litigation, died; the time to file a petition for rehearing was extended, and a petition for rehearing was filed March 21, 1946 (R. 170).

One further detail remains to be mentioned. Since undertaking to comply strictly with the terms of the Settlement Act beginning on August 11, 1941, the trustees have duly tendered to the State Treasurer certified checks covering each of the instalments of principal and interest required by said Acts. As a result, the State Treasurer up to May 2, 1946 held certified checks of the trustees aggregating $3,577,689.52, representing tenders that the trustees had made in compliance with the Settlement Acts (R. 298).

D. Present Status of the State's Tax Claims

In view of the contention of the Attorney General that the Settlement Acts being held void by the State Courts are also void here, and that the tenders were therefore annulled and that penalties at the rate of 1% per month are continuing to accrue on the principal amount of taxes claimed by the State from the date said taxes were assessed in each year, the surviving trustee, on April 15, 1946 (after a petition for certiorari had been filed in this court) filed in the Bankruptcy Court a petition (R. 287) asking the instructions of the court whether he should at that time pay out of the funds in his hands to the State the sum of $13,413,669.19 or some other sum in such way and manner as will protect the debtor's estate and stop the further running of penalties and interest on the amount so ordered paid. Exhibit "A" annexed to said petition specified the amounts of the tenders that had been made and the division thereof between principal and interest if applied under the Settlement Acts (R. 296).

After notice to all parties a hearing was held April 26, 1946 before the court (R. 298), at which the Attorney

General and many other parties appeared (R. 299), which resulted in Order No. 333 being made (R. 296), and consented to by the Attorney General (R. 298) directing the trustee to pay to the State within ten days the sum of $15,250,000 in cash on account of the tax claims of the State for the years 1932 to 1940, inclusive, including interest thereon, if any, said payment to be made under the terms specified in the order (see the terms, R. 297-298).

Paragraph 2 of said order is important. It reads as follows:

> "Except as otherwise provided in paragraph 1 of this order, the making of said payment by the trustee and the acceptance thereof by the State of New Jersey shall be without prejudice to the rights of, or the positions asserted by either of them or any party hereto in litigation now or hereafter pending relating to said claims of the State of New Jersey."

It was provided in paragraph (c) that in making the payment the trustee might use the certified checks aggregating $3,577,689.52 theretofore tendered to the State of New Jersey, "and for that purpose may regain possession of and surrender said checks for cancellation, without prejudice to the effectiveness of said tenders or any other tenders or the legal consequences that may be found to have ensued therefrom" (R. 298).

The State Commissioner's receipt for the Trustee's payment of $15,250,000 was dated May 6, 1946 (R. 318).

In view of this payment it is the petitioner's position that the tax liability of the debtor to the State of New Jersey, has now been fully discharged.

IV

Specification of Errors

The errors stated in the petition for rehearing and assigned here are as follows:

(1) The Circuit Court of Appeals erred in holding that the jurisdiction of the Bankruptcy Court under the peculiar facts of this case was limited to passing upon mathematical errors, or errors of law in the assessments.

(2) The Circuit Court of Appeals erred in failing to pass on the primary issue raised by the State's appeal, i. e. whether or not the nature, amount and priority of the State's alleged lien is within the jurisdiction of the Bankruptcy Court.

(3) The Circuit Court of Appeals erred in failing to recognize the broad functions of the Bankruptcy Court in the practical administration of Section 77 of the Bankruptcy Act, 11 U. S. C. A. 205.

(4) The Circuit Court of Appeals erred in denying the right of the Bankruptcy Court to determine whether a valid agreement of compromise, binding on the State and the trustees, had been made by the State passing the Railroad Tax Settlement Acts and the trustees accepting the provisions thereof, on court order, which involved the waiver of excessive and uncollectible penalties by the State on the one hand, and on the other the discontinuance and abandonment by the trustees of pending appeals in State tribunals and in the courts from excessive assessments and illegal rates and an undertaking to pay the principal of the disputed taxes with interest at 3%, including the payment of retroactive and discriminating

franchise taxes assessed retroactively during the bankruptcy proceedings, and the payment of large additional interest items.

(5) The Circuit Court erred in reversing Order No. 271.

Summary of Argument

(1) The State's plea that the trustees' petition for adjudication as to the State's tax claims is a suit against the State without its consent is without merit because: (a) the State filed in the proceedings, as required by Section 57(n) of the Bankruptcy Act, its verified proof of claim; (b) the Attorney General representing the State appeared generally in the proceedings both before and after the proof of claim was filed and demanded and the State accepted payments on account of its tax claims aggregating $18,000,000, which the trustees, on Court order, paid out of general assets of the debtor; (c) all of which amounted to a waiver by the State of all immunity respecting the complete adjudication of said claims.

(2) The Bankruptcy Court has exclusive jurisdiction to determine all questions as to the amount, priority and legality of the State's tax claims not only because of the provisions of the Bankruptcy Act which now require a State to file its claim in the proceedings and further provides that in case any question arises as to the amount or legality of any taxes such question shall be heard and determined by the Court; but also because it is thoroughly settled by a long line of decisions of this Court that the filing of a petition is an assertion of jurisdiction by which the Bankruptcy Court acquires exclusive jurisdiction within the field of the law and the sweep of federal statutes and under equitable principles to determine all questions in the proceedings relating to claims, liens, assets and the administration thereof, to the end that a fair and equitable plan for the reorganization of the debtor may speedily be devised.

(3) The Circuit Court of Appeals erred in reversing the order of the District Court which referred all matters arising from the State's claims and the objections thereto to a Special Master and in determining that the only matters left open for decision were mathematical error in the computation of the amount of taxes or legal error in their assessment, because, among other reasons, the trustees had properly raised the question whether a compromise of the State's claims had been effected under Section 27 of the Bankruptcy Act by the State passing and the trustees, on court order, accepting the provisions of Railroad Tax Settlement Acts of 1941 and 1942 and fully complying therewith. The trustee contends that said compromise is valid not only under Section 27 of the Bankruptcy Act but also under New Jersey law, and that the decision of the State Courts in *Wilentz* v. *Jendrickson*, on which the Attorney General relies and in which neither the debtor nor the trustees were parties, is not *res adjudicata*.

(4) A substantial question which the Circuit Court ignored and which must be decided before there can be a reorganization of the debtor is whether the State has lost its alleged lien for taxes (a) by demanding and accepting payments on account aggregating $18,000,000 out of the general funds of the debtor; (b) by repealing the statute which gave the lien asserted and at the same time enacting a new tax law which attempts not only to preserve but also to change the date when the alleged lien became effective in each year and extend the lien to assets of the debtor that were not covered by the lien under the law in existence when the taxes were assessed; and (c) by accepting payments from the debtor's trustees equal to the principal of the taxes in default plus 3% interest from December 1, 1940, in accordance with the provisions of the Tax Settlement Acts, which in terms provided that when such amounts were paid the lien of the State was discharged.

POINT I

The State's plea that the trustees' petition for adjudication as to the State's tax claims is a suit against the State, without its consent, is without merit.

We have shown in the Statement of Facts how the State, by its Attorney General, appeared in the reorganization proceedings and applied for orders directing that something be paid on account of taxes before trustees were appointed, and after trustees were appointed urged that as much as possible be ordered paid on account of taxes.

The State, by its Comptroller, filed its proof of claim (R. 64) for over $12,000,000 in taxes and nearly $8,000,000 in penalties, verified December 15, 1940. When objections were filed by the trustees to the tax claims the Attorney General for the State filed a reply on March 26, 1941 (R. 242), and when the trustees filed supplemental and amended objections and defenses to the State's claims the Attorney General for the State filed an elaborate reply thereto (R. 90). When a bondholders' committee and trustee on the debtor's mortgage filed objections to the State's claim (R. 112), dated November 22, 1944, the Attorney General for the State filed a reply thereto on December 28, 1944 (R. 115).

The claim of the State was filed as required by Section 57(n) of the Bankruptcy Act, Tit. 11, U. S. C. A., Sec. 93(n), amendment of June 22, 1938, C. 575, Sec. 1, 52 Stat. 866.

The Attorney General can scarcely assert that the State Comptroller lacked authority to file a proof of claim, because N. J. R. S. 52:19-10 authorizes and directs the State Comptroller to

> "institute and direct prosecutions * * * for just claims and debts due to the State."

And R. S. 52:19-15 directs that

> "The Comptroller shall cause suit to be instituted in any competent court of this or any other State for the recovery of any moneys due to the State * * *. The suit shall be in the name of the 'State of New Jersey' as plaintiff."

The Attorney General's further contention that since he alone has authority to enforce the State's liens the Comptroller lacked authority to file a proof of claim in a bankruptcy proceeding is disposed of by N. J. R. S. 54:27-4, which provides respecting railroad taxes as follows:

> "the taxes shall be a lien paramount to all other liens upon all the lands and tangible property and franchises of the company in this State. The liens shall take effect on June 1st of the year in which the tax is payable, and *shall be a debt due from the company to the State on that date for which an action at law or suit in equity may be maintained* and shall be a preferred debt in case of insolvency. These remedies are in addition to the special proceedings provided for in Chapters 19 to 29 of this title."

The "special proceedings" referred to for enforcing the State's alleged lien consists of the entry by the Attorney General of a summary judgment in the Supreme Court and thereafter the issuance of execution directed to a Master in Chancery to make sale. The threat of this special proceeding is what caused the debtor to file its petition for reorganization in 1939.

It thus appears that the statutes authorize as remedies for the collection of delinquent railroad taxes (a) an action at law for debt, (b) a suit in equity to foreclose the tax liens, (c) the assertion of a "preferred debt in case of insolvency" and (d) a special proceeding by the Attorney

General to enforce the lien. Obviously the Attorney General's assumption that the only remedy provided by law for the collection of the taxes in question is a proceeding by him to enforce the lien is wholly unfounded. The legislature evidently anticipated that, under certain conditions, the enforcement of a tax lien might not be a satisfactory remedy and so provided the three other remedies referred to, including, in the case of an insolvent taxpayer, the presentation of the State's claim as a "preferred debt", and in addition expressly authorized the State Comptroller to "institute" suit on such a tax claim "in any competent court."

It is submitted that the filing of the State's proof of claim by the State Comptroller in the Bankruptcy Court was expressly authorized, and said claim having been duly filed, invoked the jurisdiction of the Bankruptcy Court.

The above considerations completely dispose of any suggestion that the State did not submit itself to the Court's jurisdiction. The Attorney General, however, next contends that even though the State filed its claim in the Bankruptcy Court and urged and accepted very large payments thereon, nevertheless the State intended only to protect its claim for any deficiency and has refrained from submitting to the Court for adjudication any question respecting its alleged lien, and that therefore the Bankruptcy Court can make no determination that will in any way affect said lien.

It is submitted that the answer to these contentions is found (1) in the nature and effect of a sworn proof of claim; and (2) in the Bankruptcy Act, Section 57 (Tit. 11, U. S. C. A., Sec. 93); Section 64 (Sec. 104, 11 U. S. C. A.) and Section 77. (Sec. 205, 11 U. S. C. A.)

(1) The filing of a sworn proof of claim is *prima facie* evidence of its allegations (*Whitney* v. *Dresser*, 200 U. S. 532). When such a claim is filed, if it is disputed, it becomes the duty of the trustee, or other persons in interest

duly to object to the allowance thereof. Obviously the filing of such objections does not constitute a suit against the state. *Wiswall* v. *Campbell*, 93 U. S. 347, 351; *In re General Film Corp.*, 274 Fed. 903 (C. C. A. 2nd 1921); *In re Williams Oil Corp.*, 265 Fed. 401 (D. C. Ky. 1930); *In re McClure*, 21 Fed. 2nd 538.

(2) Section 77 (b) (1), 11 U. S. C. A. 205 (b) (1) as enacted in 1933 provides that any plan of reorganization

> "shall include provisions modifying or altering the rights of creditors generally, or of any class of them, *secured or unsecured*, either through the issuance of new securities of any character or otherwise."

and paragraph (b) (5) provides that the plan

> "shall provide adequate means for the * * * satisfaction or modification of any *liens*, indentures, or other similar interests, the curing or waiver of defaults", etc.

The same paragraph provides that the term

> " 'claims' includes debts whether liquidated or unliquidated, securities (other than stock and option warrants to subscribe to stock), *liens*, or other interests of whatever character."

In 1938, five years after the above all-inclusive provisions were enacted in Section 77, Section 57 of the Bankruptcy Act, 11 U. S. C. A. 93 (d), was drastically amended, doubtless in the light of the new provisions of Section 77, so that today Section 57, paragraph (d), provides that:

> "Claims which have been duly proved shall be allowed upon receipt by or upon presentation to the court unless objection to their allowance shall be made by parties in interest."

Paragraph (f) of that section provides that:

> "Objections to claims shall be heard and determined as soon as the convenience of the court * * * will permit."

Paragraph (n) provides that:

> "all claims provable under this title, including all claims of the United States, *and of any State or subdivision thereof*, shall be proved and filed in the manner provided in this section."*

We submit that it is thoroughly settled by the decisions of this court in *Isaacs, Trustee* v. *Hobbs Tie & Timber Co.*, 282 U. S. 734, 1931 and *Straton* v. *New*, 283 U. S. 318,

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* The House Committee Report (House Rep. 1409, 75th Cong., First Sess., at p. 13), recommending the a ve amendment of Section 57 (n) stated:

> *"All proofs of claim, except as otherwise provided in chapters X, XI, XII, and XIII, including claims for taxes and debts owing to a government, must be filed and proved.* The provision in respect to government claims is added in order to overcome the decisions which hold that the bar time for the filing of claims is not binding upon a sovereign. Thus the administration of the estate is speeded up, and the distribution becomes more certain and definite."

and the Senate Committee Report (Sen. Rep. 1916, 75th Cong., Third Sess., pp. 5, 6 and 16) stated:

> "The committee agrees with the proposal that governmental claims should be subjected to the same requirements as other claims * * *."
>
> "The provisions relative to the proof and allowance of claims have been greatly improved. Reference has already been made with reference to contingent claims and concerning the filing of Government claims and the extension of time therefor."

Thus the very purpose of this amendment was to "subject governmental claims to the same requirements as other claims" as had already been done by the broad language of Section 77.

that the jurisdiction of the Bankruptcy Court to determine the questions raised in the trustee's petition for adjudication is not only exclusive but that it is broad enough to make every determination necessary to accomplish the purposes of reorganizing the debtor in the manner provided by the Bankruptcy Act.

The State, having appeared in the reorganization proceedings in the manner it did and having filed its claim and having filed answers to the objections thereto, has waived all immunity respecting the complete adjudication of said claim. *Clark* v. *Barnard*, 108 U. S. 436, 447; *Gunter* v. *Atlantic Coast Line*, 200 U. S. 273, 284; *Porto Rico* v. *Ramos*, 232 U. S. 627; *Missouri* v. *Fiske*, 290 U. S. 18. See, also, *In Re Barnett*, 12 Fed. (2d) 73 (C. C. A. 2nd); cert. den. 273 U. S. 699.

POINT II

The Bankruptcy Court has exclusive jurisdiction to determine, and must determine in these proceedings, (A) the nature and extent of the State's alleged liens; and (B) the amount, priority and legality of the State's tax claims.

A

As to the Nature and Extent of the State's Alleged Liens

The Bankruptcy Court has at all times had exclusive jurisdiction as to the nature and extent of all types of liens asserted in bankruptcy proceedings.

In *Ex parte City Bank of New Orleans*, 3 How. 292 (1845), which arose under the Bankruptcy Act of 1841, a mortgagee of property owned by a bankrupt, without filing a claim in the Bankruptcy Court, undertook to foreclose his mortgage in a State Court, an issue being sharply raised as to the power of a Bankruptcy Court to deal with the rights of a lien holder. The mortgagee contended that in view of the provisions of the early Bankruptcy Act that nothing therein "shall be construed to annul, destroy or impair any lien", it followed that the Bankruptcy Court had no jurisdiction over the mortgage.

In rejecting this argument Mr. Justice Story, speaking for a unanimous court, said:

> "There is no doubt that the liens, mortgages and other securities within the purview of this proviso, so far as they are valid by the State laws, are not to be annulled, destroyed or impaired under the proceedings in bankruptcy; but, they are to be held of equal obligation and validity in the courts of the United States as they would be in the State courts.

> "The District Court, sitting in bankruptcy, is bound to respect and protect them but this does not and cannot interfere with the jurisdiction and right of the Bankruptcy Court to inquire into and ascertain the validity and extent of such liens and mortgages, and other securities, and to grant the same remedial justice and relief to all the parties interested therein as the State courts might or ought to grant * * *. The rights and remedies in such cases are entirely distinct. While the former are to be fully recognized in all courts, the latter belong to the *lex fori*, and are within the competency of the national courts equally with the State courts" (pp. 315, 316).

In answer to the suggestion that assumption of jurisdiction by the Bankruptcy Court would operate to suspend or control proceedings in the State Courts, the opinion explained that the Bankruptcy Court would exercise its control,

> "not by acting on the (State) Courts over which it possesses no authority; but by acting on the parties through the instrumentality of an injunction * * *."

As justification for the Bankruptcy Court thus assuming jurisdiction of liens affecting the property of a bankrupt, the opinion continued:

> "The judicial power of the United States is by the constitution competent to all such purposes; and Congress by the Act intended to secure the complete administration of the whole system in its own courts as it constitutionally might do" (p. 320).

And further:

> "The truth is that in no other way could the bankruptcy system be put in operation without interminable doubts, controversies, embarrassments and diffi-

culties, or in such manner as to achieve the true end and design thereof. Its success was dependent upon the national machinery, being made adequate to all the exigencies of the Act" (p. 321).

In re Tyler, 149 U. S. 164 (1893), while property of an insolvent was in the custody of a receiver appointed by the Federal Court, a sheriff seized it on account of State taxes and when arrested by a United States Marshal for contempt defended on the ground that, while unauthorized interference with property *in custodia legis* is ordinarily punishable as contempt, that principle does not apply to the collection of State taxes and that the process against him was therefore a suit against the State. This Court held that the rule as to *custodia legis* applied where a State tax lien was involved, as in other cases, saying:

"• • • And when controversy arises as to the legality of the tax claimed there ought to be no serious difficulty in adjusting such controversy upon proper suggestion. The usual course pursued in such cases is by intervention pro interesse suo, as in the instance of sequestration. (Citations.) The tax collector is a ministerial officer (citations); and no reason is perceived why he should not bring his claim to the attention of the Court, while, on the other hand, it is clearly the duty of the receiver to do so if he contends that the taxes are illegal. If found valid, they must be paid; if invalid, the Court will so declare, subject to the review of the appellate tribunals."

This holding was subsequently approved by a unanimous court in the opinion by Mr. Justice Brandeis in *Marshall v. New York*, 254 U. S. 380 (1920), where the court said:

"Since the prerogative right of the State could not be enforced by levy and seizure, an application

to the court for payment of the debt due was the appropriate remedy."

In *First National Bank* v. *Staake*, 202 U. S. 141 (1906), a question arose as to the validity of a decree of a Bankruptcy Court preserving, under Section 67(f) (11 U. S. C. A. 107(f)) for the benefit of creditors, a voidable lien that had been secured within four months of bankruptcy. In holding the decree valid, this Court said:

> "To what extent liens obtained by prior judicial proceedings shall be recognized is a matter wholly within the discretion of Congress • • •" (p. 148).

And in answering the contention of the lien creditor that his lien was beyond the reach of the court, the opinion continued:

> "The general rule relied upon by the bank (the attaching creditor) in this case that the words 'property of the bankrupt' mean only the property to which the bankrupt is beneficially entitled and do not include property to which he has only a bare legal title, is perhaps justified by our decision, in Hewit v. Berlin Machine Works, 194 U. S. 296. But the extent to which the Bankruptcy Court shall recognize the rights obtained by creditors upon property attached as the property of the bankrupt, though in fact, such property had been conveyed by an unrecorded contract, is a matter solely within the discretion of Congress. The liens acquired in this case were liens upon property which, as to attaching creditors, was the property of the bankrupt, and Congress may lawfully insist that it shall be reckoned as a part of his estate, and passed to the Trustee" (p. 149).

In *Isaacs, Trustee* v. *Hobbs Tie & Timber Co., supra,* the question was presented whether, after a Bankruptcy

Court had acquired jurisdiction, a lien creditor of the bankrupt, who had filed no claim, might proceed in a State Court to foreclose. This court (Mr. Justice Roberts) said:

> "Upon adjudication, title to the bankrupt's property vests in the trustee with actual or constructive possession, and is placed in the custody of the Bankruptcy Court. Mueller v. Nugent, 184 U. S. 1, 14. The title and right to possession of all property owned and possessed by the bankrupt vests in the trustee as of the date of the filing of the petition in bankruptcy, no matter whether situated within or without the district in which the court sits. Robertson v. Howard, 229 U. S. 254, 259-260; Wells v. Sharp, 208 Fed. 393; Galbraith v. Robson Hilliard Grocery Co., 216 Fed. 842. It follows that the bankruptcy court has exclusive jurisdiction to deal with the property of the bankrupt estate. It may order a sale of real estate lying outside the district. Robertson v. Howard, supra; In re Wilka, 131 Fed. 1004. When this jurisdiction has attached the court's possession cannot be affected by actions brought in other courts."

And further:

> "Thus, while valid liens existing at the time of the commencement of a bankruptcy proceeding are preserved, it is solely within the power of a court of bankruptcy to ascertain their validity and amount and to decree the method of their liquidation. Ex Parte City Bank of New Orleans, 3 How. 292; Houston v. City Bank of New Orleans, 6 How. 486; Ray v. Norseworthy, 23 Wall. 123; In re Wilka, supra; Nisbet v. Federal Title & T. Co., 229 Fed. 644."

In *Straton* v. *New, supra,* the District Court entered an order in the bankruptcy of the Fall Branch Coal

Company, enjoining commissioners appointed by a West Virginia State Court from proceeding with the sale of certain real estate of the bankrupt pursuant to a decree of that court. The trustee's petition alleged that commissioners were advertising for sale only the property of the bankrupt in West Virginia, that it would be advantageous to all parties to have this property sold with property of the bankrupt situate in Kentucky, and that the Bankruptcy Court had exclusive jurisdiction to make the sale. Respondents in their answer denied the right of the Bankruptcy Court to enjoin the proceedings in the State Court and appealed from an order awarding an injunction. This court (Mr. Justice Roberts) said:

> "The filing of the petition is an assertion of jurisdiction with a view to the determination of the status of the bankrupt and a settlement and distribution of his estate. This jurisdiction is exclusive within the field defined by the law, and is so far in rem that the estate is regarded as *in custodia legis* from the filing of the petition. Acme Harvester Co. v. Beekman Lumber Co., 222 U. S. 300. It follows that liens cannot thereafter be obtained nor proceedings be had in other courts to reach the property, the District Court having acquired the exclusive right to administer all property in the bankrupt's possession. Lazarus v. Prentiss, 234 U. S. 263; White v. Schloerb, 178 U. S. 542; Murphy v. John Hofman Co., 211 U. S. 562; U. S. Fidelity & G. Co. v. Bray, 225 U. S. 205; Hebert v. Crawford, 228 U. S. 204. It may inquire into the validity of liens, marshal them and control their enforcement and liquidation. Isaacs v. Hobbs Tie & Timber Co., 282 U. S. 734, and authorities cited."

In *Van Huffel* v. *Harkelrode*, 284 U. S. 225 (1931), after a sale, free from liens, had been ordered by a Bankruptcy Court, a County Treasurer, who had received

notice of the application to sell and in response had mailed a statement of the taxes due, asserted a lien on the property for unpaid taxes accrued prior to bankruptcy. The purchaser then sued in a State Court for a decree confirming this title and on refusal of such decree, this Court granted certiorari. The State insisted that the decree of the Bankruptcy Court was invalid because that Court lacked jurisdiction to sell the property free of the State's tax lien, even though the lien was transferred to the proceeds of sale. In sustaining the decree, even though the Bankruptcy Act, at that time, did not expressly confer power to sell free from liens, this Court held that such power was implied, stating:

> "No good reason is suggested why liens for state taxes should be deemed to have been excluded from the scope of this general power to sell free from encumbrances. Section 64 of the Bankruptcy Act grants to the court express authority to determine 'the amount or legality' of any tax. To transfer the lien from the property to the proceeds of its sale is the exercise of a lesser power; and legislation conferring it is obviously constitutional. Realization upon the lien created by the state law must yield to the requirements of bankruptcy administration. Compare International Shoe Co. v. Pinkus, 278 U. S. 261; Isaacs v. Hobbs Tie & Timber Co., 282 U. S. 734; Straton v. New, 283 U. S. 318. In many of the cases in the lower federal courts the order of sale entered was broad enough to authorize a sale free from tax liens as well as from others; and in some of them it appears affirmatively that liens for taxes were treated as discharged by the order. No case has been found in which the power to sell free from the lien of state taxes was denied."

In *New York* v. *Irving Trust Company*, 288 U. S. 329 (1933), after a Bankruptcy Court had entered a bar order

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as to "all claims which the State of New York may have against the estate", the State filed a notice of possible demand for taxes accrued prior to bankruptcy and on motion of the trustee the notice was expunged. Certiorari was granted upon the State's complaint that the order expunging its notice was "incompatible with state sovereignty". In dismissing the complaint this Court held:

> "The federal government possesses supreme power in respect of bankruptcies. International Shoe Co. v. Pinkus, 278 U. S. 261, 265. If a state desires to participate in the assets of a bankrupt, she must submit to appropriate requirements by the controlling power; otherwise, orderly and expeditious proceedings would be impossible and a fundamental purpose of the Bankruptcy Act would be frustrated."

Following the above decisions, the Ninth Circuit in *In re Florence Commercial Co.*, 19 Fed. (2d) 468 (1927), where a County Treasurer, who had seized merchandise to enforce a tax lien, contested the order of the Bankruptcy Court authorizing the sale of the property free from lien and requiring that the County Treasurer establish the validity and amount of his claim against the proceeds, held:

> "Nor are we inclined to the narrow view that, while there may be jurisdiction to determine the amount of the tax, it does not extend to the incidental matter of the tax lien. The bankruptcy court is to see to it that the estate fully discharges all legal obligations in respect of taxes; and accordingly it is invested with power to decide all questions incidental to the performance of that duty."

The pertinent provisions of the Bankruptcy Act relating to the nature and extent of statutory liens asserted in bankruptcy proceedings are contained in sections 67 b and c (11 U. S. C. A. 107 b & c). In connection with those

sections it is necessary to examine Section 64 a (11 U. S. C. A. 104 a). Because of their length we have included them in the annexed Appendix.

The New Jersey statute on which the State relied in filing its claim provided that:

> "These taxes shall be a lien paramount to all other liens upon all the lands and tangible property and franchises of the company in this State" (Rev. 54:19-1).

The alleged lien asserted by the State of New Jersey against the debtor for taxes is in the nature of an inchoate statutory lien.

Two of the leading cases in this court construing statutory liens similar to those created by the tax statutes of the State of New Jersey are: *New York* v. *Maclay*, 288 U. S. 290 and *United States* v. *State of Texas*, 314 U. S. 480.

The *Maclay* case dealt with a franchise tax statute of the State of New York which provided:

> " 'Every such tax or fee (including the annual franchise tax to be paid by corporations) shall be a lien and binding upon the real and personal property of the corporation * * * liable to pay the same until the same is paid in full.' N. Y. Tax Law, Consol. Laws, chap. 60, §197."

Justice Cardozo said, at pages 292, 293 and 294:

> "The lien thus created is effective for many purposes though its amount is undetermined. It is notice to mortgagees or purchasers, who are held to loan or purchase at their own risk if they take their mortgages or deeds before the tax has been assessed or paid. (Citing cases.) * * *
>
> "The problem here is different. To hold that a lien has progressed to such a point as to be a warning

to mortgagees and purchasers of a contingent liability, like a notice of lis pendens, is far from holding that while the liability is unliquidated and unknown the lien thus created is perfect and specific. By the terms of the hypothesis it is nothing of the kind. If the State were to stand upon the warning and omit to ascertain the debt, it would never be able to sell anything, for it would not know how much to sell. Against mortgagees and purchasers a lien perfected afterwards may take effect by relation as of the date of the inchoate lien through which mortgagees and purchasers became chargeable with notice. The doctrine of relation will not divest the United States of the preference that accrued when receivers were appointed."

Justice Cardozo in conclusion said:

"Enough for present purposes that the statutory preference must prevail against the lien of a tax not presently enforceable, but serving merely as a caveat of a more perfect lien to come."

United States v. *Texas, supra,* dealt with a lien arising under a gasoline tax statute of that State which declared that all gasoline taxes due by any distributor to the State "shall be a preferred lien first and prior to any and all other existing liens upon all the property of the distributer devoted to or used in his business as a distributer".

Justice Byrnes, after discussing the *Maclay* case at length, said (pp. 487, 488):

"As to the nature of the proper procedure for levy, seizure, and sale, it is enough to say that some procedure is essential. As we have indicated, the statutory scheme reveals that the legislature contemplated resort to the courts. In addition to the statutory provisions referred to above, Article

7065a-8(e) regulates the pleadings in suits by the Attorney General to collect the tax, and Article 7065a-9 determines the venue of such suits. Consequently, while it was clearly intended by Article 7065a-7 to create a lien in favor of the state, we must conclude that of necessity it was nothing more than an inchoate and general lien. Certainly it did not of its own force divest the taxpayer of either title or possession. It could not become specific until the exact amount of the taxes due had been determined, and it could not be enforced without the assistance of the courts. Like the tax lien in New York v. Maclay, supra, it served 'merely as a caveat of a more perfect lien to come.' ''

In *City of New Orleans* v. *Harrell,* 134 Fed. (2d) 399, (C. C. A. 5th), the City of New Orleans claimed the status of a secured creditor of a bankrupt by reason of an alleged lien for taxes on movables. It asserted a lien prior to a chattel mortgage lien under the Constitution and Laws of Louisiana. The district court held that no such lien existed prior to seizure, and postponed payment of the taxes under Sections 67 b and c of the Bankruptcy Act. Circuit Judge Holmes, in discussing the nature of the lien asserted in the cited case and its postponement in time of payment to the lien of the chattel mortgage, said, page 400:

"Briefly to summarize: The nature and effect of a lien, within the meaning of the Bankruptcy Act, is governed by the law of the state where the bankrupt's property is situated. Prior to said Act of June 22, 1938, statutory liens that were inchoate or incomplete, and had to be perfected by seizure, did not survive in bankruptcy unless the seizure took place before the petition in bankruptcy was filed. Section 67, sub. b of said Act now permits such liens to be perfected by filing notice thereof with the bank-

ruptcy court; this notice was not given in the case before us; but, if it had been, the result would be the same, because by subdivision c thereof the lienor would be placed in a special class of secured creditors whose claims are postponed in payment to the debts specified in clauses (1) and (2) of Section 64, sub. a of said Act."

Judge Hutcheson, in a concurring opinion in the same case, said, page 402:

"Because of Section 67, sub. c, the City of New Orleans must, to prevail, establish more than that it had a statutory tax lien on personal property which arose before bankruptcy and was, therefore, valid both before and under Sec. 67, sub. b. It must establish that before bankruptcy its lien was accompanied by possession of the property, and since it stands admitted that it did not have possession, its claim must fall."

In a subsequent case citing the *Harrell* case, to wit, *City of New York* v. *Hall,* 139 Fed. (2d) 935 (C. C. A. 2nd), Judge Frank in discussing Sections 67 b and c of the Bankruptcy Act, *supra,* said:

"Enough has been done here to bring the City's claims within Section 67, sub. b, 11 U. S. C. A. §107, sub. b. The sole issue is whether they came within Section 67, sub. c, so that they are subordinated to the administration expenses covered by clauses (1) and (2) of Section 64, sub. a, 11 U. S. C. A. §104, sub. a. And that depends on whether the lien was 'accompanied by possession' of the property, which, in turn, depends on the answer to the question whether 'possession', as used in Section 67, sub. c, means merely 'constructive' possession, for obviously there was not actual possession by the City at the time of the filing of the bankruptcy petition.

"The word 'possession' drips with ambiguity. It is not a single purpose word and must be contextually construed. That for some purposes, under some sections of the act, it may include 'constructive' possession gives us no answer to our question. We are convinced that Section 67, sub. c, meant something more. The aim of that amendment is well discussed in 4 Moore's Collier on Bankruptcy (14th Ed.) 163-164: 'As a result of long inaction of tax authorities, liens for taxes which accumulated over a number of years often consumed a bankrupt's entire estate, even to the exclusion of costs and expenses of the bankruptcy proceedings'. The facts here are illustrative: the City's claims are for taxes which had accumulated for seven or eight years respectively. Notwithstanding the admonition of Section 67, sub. c, the City chose to slumber on its rights. Congress intended to penalize such somnolence.

"In Section 67, sub. c, Congress obviously had uniformity in mind. Consequently, New York decisions concerning the effect on other creditors of such action as that, here taken by the City, are not controlling. Whether a lien exists within Section 67, sub. b, is a question of State 'law'. Whether steps taken pursuant to State 'law' are sufficient to constitute 'possession' under 67, sub. c, is a question of Federal 'law'. That conduct must adequately warn potential petitioning creditors of the existence of the lien. The City's action did not satisfy that test."

The application of Sections 67 b and c, *supra,* to real estate and personal property and the assertion of statutory liens as in the case at bar upon such property by a State is dealt with in the case of *In re Pennsylvania Brewing Co.,* 114 Fed. (2d) 1010 (C. C. A. 3rd); cert. den. 312 U. S. 685. In that case, after discussing the contentions

of the appellees regarding statutory liens upon real and personal property, Judge Biggs said:

> "We are of the opinion that Congress has elected to treat personal property and real estate upon different bases. This is clearly one of the purposes of Section 67, sub. c. If there is a statutory lien upon personal property not accompanied by possession or a distress for rent (which is always upon personal property) whether statutory or not, such liens are postponed in payment to expenses of administration and wage claims. If, however, the statutory lien is upon real estate, it is not postponed but is payable strictly pursuant to the provisions of Section 67, sub. b."

Sections 67 b and c and Section 64 of the Bankruptcy Act, were held to be applicable in railroad reorganizations under Section 77 of the Bankruptcy Act in the case of *Lyford* v. *State of New York,* 140 Fed. (2d) 840 (C. C. A. 2nd); cert. den. 323 U. S. 714. In the case cited the State of New York asserted a statutory lien under the Grade Crossing Removal Act of that State in the reorganization of the New York, Ontario & Western Railroad Company, which had filed its petition under Section 77 of the Bankruptcy Act. The State statute provided for a first and paramount lien upon all real property of a railroad corporation. Judge Frank said, at page 845:

> "The State here stresses particularly the new provisions of the Chandler Act amending §67, sub. b, of the Bankruptcy Act, 11 U. S. C. A. §107, sub. b, to the effect that statutory liens for debts owed a state, which are required by state law to be perfected and which arise but are not perfected before bankruptcy, may be valid if perfected thereafter according to state law. The district court held this provision inapplicable because it was not expressly made ap-

plicable to railroad reorganizations as it was to petitions under Chapters X to XIII of the Act, 11 U. S. C. A. §§501 et seq. to 1001 et seq., adding that it would have been easy for Congress to have made the express application had it so desired. But §77, sub. 1, 11 U. S. C. A. §205, sub. 1, states that in railroad reorganization proceedings, 'and consistent with the provisions thereof,' the bankruptcy court's jurisdiction and powers and the rights and liabilities of all persons with respect to the debtor and its property are the same as in ordinary bankruptcy. In Lyford v. City of New York, 2 Cir., 137 F. 2d 782, we made use of this statute to say that §64, sub. a, of the Act, 11 U. S. C. A. §104, sub. a, could be applied, at least by analogy, to §77 reorganizations; and in New York Trust Co. v. Palmer, 2 Cir., 101 F. 2d 1, we held §57, sub. h, not to be inconsistent and hence applicable. Other aspects of §67, sub. b, apart from the perfection clause with which we are now concerned, have been utilized in connection with §77, Board of Directors of St. Francis Levee Dist. v. Kurn, 8 Cir., 98 F. 2d 394, certiorari denied 305 U. S. 647, 59 S. Ct. 153, 83 L. Ed. 418; Thompson v. Glover, 8 Cir., 94 F. 2d 544; In re Erie R. Co., D. C. N. D. Ohio, 37 F. Supp. 237; and Professor Moore strongly urges its applicability, 4 Collier on Bankruptcy, 14th Ed. 1942, 170, 5 id., 1943, 490, 540. On the whole it seems more rational to apply the bankruptcy provisions where they are 'consistent,' and there seems no inconsistencies in the terms of §67, sub. b, as applied to proceedings such as this. Even though the Chandler Act was passed after these proceedings began, the better view, even earlier, was in accord with its principle. See 4 Collier on Bankruptcy 228-230, with extensive citation of cases. It states a reasonable and convenient method of proceeding which we see no reason to disavow here."

At the time of the filing of the petition by the debtor for reorganization nothing had been done by the State of New Jersey to perfect its alleged lien on either real or personal property of the debtor. It was the threat of the Attorney General to enter summary judgment and issue execution that was the immediate cause of the filing of the debtor's petition (*supra*, p. 40).

It is accordingly respectfully submitted:

(1) That the State has never had and cannot now claim a lien on any of the personal property of the debtor, and that

(2) One of the fundamental questions that the Bankruptcy Court and it alone must decide is the nature and extent of the alleged liens of the State and the liens of bondholders on the various classes of property of the debtor.

B

As to the Amount, Priority and Legality of the State's Tax Claims

This Court has repeatedly held that the Bankruptcy Courts have full and complete jurisdiction to determine the amount, priority and legality of the claims of all creditors, including the claim of any State or municipality, and that the Bankruptcy Court will apply the pertinent provisions of the bankruptcy statute.

In *Wragg* v. *Federal Land Bank of New Orleans;* 317 U. S. 325, the late Chief Justice Stone in his opinion said:

> "In the interpretation and application of the Bankruptcy Act as in the case of other federal statutes, federal not local law applies. Prudence Realization Corp. v. Geist, 316 U. S. 89, 95, 86 L. ed. 1293, 1298, 62 S. Ct. 978, and cases cited. It is for the bank-

> ruptcy court to determine, by reference to the provisions of the bankruptcy statute, what rights created by state law—regardless of the characterization which may be applied to them by state statutes and decisions—are within the jurisdiction of the bankruptcy court. United States v. Pelzer, 312 U. S. 399, 402, 403, 85 L. ed. 913, 915, 916, 61 S. Ct. 659."

As this Court recently made clear in *Pepper* v. *Litton*, 308 U. S. 295; *Prudence Realization Corp.* v. *Geist*, 316 U. S. 89, and *Heiser* v. *Woodruff*, 66 Sup. Ct. 853, courts of bankruptcy are essentially courts of equity and where necessary to avoid inequitable results will apply federal rather than local law.* As the late Chief Justice Stone said in *Sola Electric Co.* v. *Jefferson Electric Co.*, 317 U. S. 173, *Erie Railroad Co.* v. *Tompkins*, 304 U. S. 64 is inapplicable

> "to those areas of judicial decision within which the policy of the law is so dominated by the sweep of federal statutes that legal relations which they affect must be deemed governed by federal law having its source in those statutes, rather than local law."

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* In *American Propeller & Mfg. Co.* v. *United States*, 300 U. S. 475, it was said:

> "When the United States comes into court to assert a claim, it so far takes the position of a private suitor as to agree by implication that justice may be done with regard to the subject matter."

It would seem that under this rule, since the Attorney General has delayed a decision as to the amount of the State's claims since September 4, 1941, by filing the civil information suit in the State Courts; by his appeal from Order No. 163 after failing to appeal from Order No. 135; by his special appearance filed August 22, 1944; his appeal from Order No. 271 and his petition for a writ of prohibition to the Circuit Court, it would be most unjust and inequitable in any event to allow the State to recover penalties of 1% per month as a preferred claim or lien.

Even before the Bankruptcy Act in the 1938 amendment specifically provided that the tax claims of a State must be filed and that a State which did not file its claim in the Bankruptcy Court might be barred (Section 57n, 11 U. S. C. A. 93(n)), it was the settled law that bankruptcy courts, as part of their inherent power, had jurisdiction to ascertain the validity, amount and priority of all liens, including the tax liens of a State, and that if a State in a bankruptcy proceeding did not appear, it incurred the risk that its tax claim, even though secured by a lien, might be forever barred.

Under the provisions of Section 77 of the Bankruptcy Act, Congress expressly conferred on Bankruptcy Courts handling railroad reorganization proceedings the jurisdiction that this Court had previously held was inherent in courts handling ordinary bankruptcy proceedings.

Thus Section 77, after providing the following definitions in subsection (b):

> "The term 'creditors' shall include, for all purposes of this section, all holders of claims of whatever character against the Debtor or its property, whether or not such claims would otherwise constitute provable claims under this Act",

and

> "The term 'claims' includes debts, whether liquidated or unliquidated, securities, liens, or other interests of whatever character",

provides in subsection c (7) that:

> "The judge shall promptly determine and fix a reasonable time within which the claims of creditors may be filed or evidenced and after which no claim not so filed or evidenced may participate except on order for cause shown".

Section 77 also provides in subsection (1) that:

> "In proceedings under this section and consistent with the provisions thereof, the jurisdiction and powers of the Court, the duties of the debtor and the rights and liabilities of creditors, and of all persons with respect to the debtor and its property shall be the same as if a voluntary petition for adjudication had been filed and a decree of adjudication had been entered on the day when the debtor's petition was filed."

Finally, Section 77, in subsection (f) provides that upon confirmation by the judge any plan of reorganization shall

> "be binding upon * * * all creditors, secured or unsecured, whether or not adversely affected by the plan and whether or not their claims shall have been filed, and if filed, whether or not approved, including creditors who have not, as well as those who have, accepted it".

And that the plan may be carried out

> "the laws of any State or the decision or order of any State authority to the contrary notwithstanding".

And that upon confirmation of the plan

> "the property dealt with by the plan * * * shall be free and clear of all claims of the debtor, its stockholders and creditors, and the debtor shall be discharged from its debts and liabilities, except such as may consistently with the provisions of the plan be reserved in the order confirming the plan".

Shortly after Section 77 was enacted, the Trustee of a railroad in reorganization under that section was sued in a State Court on the ground that the title of part of the railroad property, of which the trustee had taken possession, had been forfeited, and in passing on the juris-

dictional question that resulted, this Court in a unanimous opinion by Mr. Justice Brandeis, in *Ex Parte Baldwin*, 291 U. S. 610 (1934), announced:

> "All property in the possession of a bankrupt, of which he claims the ownership passes, upon the filing of a petition in bankruptcy, into the custody of the Court of Bankruptcy * * *. Having possession, the Court may not only issue all writs necessary to protect its possession from physical interference, but is entitled to determine all questions respecting the same (citations)."

And further, that the exclusive jurisdiction of the Bankruptcy Court "was not limited to the prevention of interference with the use of the land" but extended "to the adjudication of questions respecting the title".

A year later this Court, in *Continental Illinois National Bank and Trust Co.* v. *C. R. I. & P. Railway Co.*, 294 U. S. 648 (1935), was confronted with the question whether an order entered by a Bankruptcy Court under Section 77, restraining secured creditors (who were not parties to the proceeding and had not been served with process but had been given notice of the hearing on which the decree was entered), from selling certain securities of the debtor railroad which they owned, was authorized by Section 77, and if so, whether said section was constitutional. In sustaining the validity of the order and the constitutionality of the Act, this Court, in the opinion of Mr. Justice Sutherland, said:

> "Section 77 advances another step in the direction of liberalizing the law on the subject of bankruptcies. Railway corporations had been definitely excluded from the operation of the law in 1910 (C. 412, Section 4, 36 Stat. 838-839) probably because such corporations could not be liquidated in the ordinary way or by a distribution of assets. A railway is a unit; it cannot be divided up and disposed of piece-meal like

> a stock of goods. It must be sold, if sold at all, as a unit and as a going concern. Its activities cannot be halted because its continuous, uninterrupted operation is necessary in the public interest; and for the preservation of that interest, as well as for the protection of the various private interests involved, reorganization was evidently regarded as the most feasible solution whenever the corporation had become 'insolvent or unable to meet its debts as they mature'" (671, 672).

And in holding that even creditors, who were not parties to the reorganization proceeding, were nonetheless subject to the decree of the Bankruptcy Court, this Court quoted with approval the following language from *Canada Southern Railway Co.* v. *Gebhard*, 109 U. S. 527:

> "Unless all parties in interest, wherever they reside, can be bound by the arrangement which it is sought to have legalized, the scheme may fail."

And finally, by way of emphasizing that the jurisdiction of bankruptcy courts over railroad property in reorganization under Section 77 was in certain respects even broader than the ordinary jurisdiction of a bankruptcy court, the opinion stated:

> "It may be that in an ordinary bankruptcy proceeding the issue of an injunction in the circumstances here presented would not be sustained. As to that it is not necessary to express an opinion. But a proceeding under Section 77 is not an ordinary proceeding in bankruptcy. It is a special proceeding which seeks only to bring about a reorganization, if a satisfactory plan to that end can be devised. And to prevent the attainment of that object is to defeat the very end the accomplishment of which was the sole aim of the section, and thereby to render its provisions futile."

Subsequently, in *Board of Directors St. Francis Levee District* v. *Kurn*, 91 Fed. (2d) 118 (C. C. A. 8th, 1937), cert. den. 302 U. S. 750, the question was squarely presented whether a bankruptcy court in a reorganization proceeding under Section 77 had jurisdiction to restrain a proceeding by a State agency (which was not a party to the reorganization proceeding) to enforce in a State Court the collection of taxes on land of the debtor railroad. In sustaining the jurisdiction of the Bankruptcy Court, the Eighth Circuit Court of Appeals held that Section 77

> "in plain terms, authorized the Court to enjoin judicial proceedings to enforce any lien upon the property"

And added:

> "Although the Arkansas statutes contemplate that the only method to enforce collection of the levee taxes is by suits in the Chancery courts of the State, such as have been brought by the levee district, the power of the bankruptcy court to determine all questions respecting the property in its possession is paramount. 'Realization upon the lien created by the state law must yield to the requirements of bankruptcy administration.' Van Huffel v. Harkelrode, 284 U. S. 225. The question of the amount and validity of the levee tax lien must be submitted to the bankruptcy court and settled by it. Ex Parte Baldwin, 291 U. S. 610; In re Tyler, 149 U. S. 164."

Finally, in *Lyford* v. *City of New York*, 137 Fed. (2d) 782 (C. C. A. 2nd, 1943), the question was presented whether the decree of a bankruptcy court adjudicating the amount and legality of the taxes levied against a railroad in reorganization under Section 77 was valid, and in sustaining the decree, the Second Circuit Court of Appeals, after noting that this Court in *Arkansas Corporation Commission* v. *Thompson*, 313 U. S. 132, had left

open the question whether Section 64a applies to railroads in reorganization, held that since Section 64a was entirely consistent with Section 77 its terms were applicable, and then added:

> "Moreover, we do not see that our problem would be greatly changed, however our conclusion is expressed as to this point. If there was no provision expressly dealing with the power to adjudicate tax claims, the court would still have to find that such a claim was legally due; its general power to pass upon claims would require no less. See In re 168 Adams Bldg. Corp., supra; Pepper v. Litton, 308 U. S. 295, 303, 304. Thus section 77 itself provides that the judge 'shall promptly determine' the manner in which claims of creditors 'may be filed or evidenced and allowed,' sub. c (7), and may refer such matters to a special master, as was done here, sub. c. (13). And there seems no reason why the general bankruptcy provision as to allowance of claims by the court, section 57, sub. d, should not apply. See New York Trust Co. v. Palmer, supra; Guaranty Trust Co. of New York, v. Henwood, 86 F. 2d 347; cert. den. 300 U. S. 661; In re Erie R. Co., 133 F. 2d 730; In re D. & R. G. W. R. Co., 27 F. Supp. 983; Continental Illinois Nat. Bank & Trust Co. of Chicago v. Chicago R. I. & P. R. Co., 294 U. S. 648, 675-678; cf. however, In re C., M., St. P. & P. R. Co., 27 F. Supp. 685."

The Special Master in the case at bar, in his Interim Report (R. 39), said:

> "In the opinion of the Master, the entire property of the railroad is *in custodia legis*, subject, however, to such rights as are given by law to lien-holders. The cases cited by the Attorney General do not hold otherwise. Having custody of the property, the Bankruptcy Court, subject to the limitation expressed in

the case of Arkansas Corporation Commission v. Thompson, 313 U. S., p. 132, supra, *which limitation is not now involved*, is the proper Court to determine the validity and amount of the tax claims of the State of New Jersey and the incidental liens alleged to affect the property in the custody of the Court. Isaacs v. Hobbs Tie & T. Co., 282 U. S., p. 734, at p. 738."

The essential point decided by this Court in *Arkansas Corporation Commission et al.* v. *Thompson, supra*, was well summarized in the opinion of Judge Clark in *Lyford* v. *City of New York, supra*, as follows:

> "• • • The effect of the Thompson case is, • • • to deny it (the Bankruptcy Court) power to review the action of a quasi judicial taxing body in setting, after due hearing, a valuation of property for tax purposes." (Parentheses supplied.) (p. 786)

However, the Circuit Court of Appeals in the case at bar in its opinion said:

> "The case of Arkansas Corporation Commission et al. v. Thompson, 313 U. S. 132, is directly in point" (R. 160).

Thus, the opinion of the Third Circuit Court of Appeals in the present case discloses that that court erroneously assumed that the primary issue as to which the Bankruptcy Court had assumed jurisdiction in this case was the amount of the assessed valuations of the debtor's property.

We have tried to make it crystal clear in the Statement of Facts that this case in no way involves any question as to the assessed valuation of the debtor's property. As a matter of fact, in this case the debtor had taken appeals from the assessment of taxes for each year through

the State Board of Tax Appeals, and as it was defeated there it had filed original bills in the United States District Court attacking the assessments as confirmed by the State Board of Tax Appeals on various constitutional grounds, which are well stated by Judge Forman in *Central Railroad Company of N. J.* v. *Martin, supra,* which determined that the taxes had been assessed in plain violation of established principles that govern property valuation.*

It was while the assessments and tax rates made by the State were being contested for the years 1937 to 1941 inclusive in the very manner held necessary by the opinion of Mr. Justice Black in the *Arkansas* case, *supra,* that the State passed the Railroad Tax Settlement Act of 1941 and held out its solemn offer of compromise to the trustees of the debtor and all other railroads in reorganization and in default which was accepted by the trustees with court approval.

There can be no doubt in this case that the trustees fully complied with their duty as stated in the *Arkansas* case, *supra.* The question here presented is entirely different. It is novel; for never before has a State by public

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* The justification for the debtor to appeal to the United States District Court for relief from illegal New Jersey taxes on the ground of the denial of the equal protection of the laws and of due process of law is shown by the decision of this Court (Mr. Justice Douglas) in *Township of Hillsborough* v. *Doris Duke Cromwell,* decided Jan. 26, 1946, 326 U. S. 620. See also *Greene* v. *Louisville & Nashville R. R. Co.,* 244 U. S. 499, 518-519; *C. R. R. Co. of N. J.* v. *Martin,* 65 F. (2d) 613; and *C. R. R. Co.* v. *Jersey City,* 199 Fed. 237, 243.

The debtor's ground of complaint as to the excessiveness of the average tax rate which was employed in fixing the tax levies for the years 1932 to 1940, inclusive, R. 73, 74, 85, 86, was waived by the trustees as one of the conditions necessary for the acceptance by them of the compromise offered by the Tax Settlement Acts hereinafter mentioned.

laws made to a Bankruptcy Court an offer of compromise of vast taxes and penalties thereon, and after the acceptance of such an offer by the court and its trustees attempted to repudiate such offer and at the same time retain the benefits it had received by such acceptance, to wit: the discontinuance of all pending appeals properly taken under State law in the manner indicated as necessary in the *Arkansas* decision of this Court, and the termination of all litigation with respect to such taxes.

We submit it is thoroughly established that the Bankruptcy Court has sole jurisdiction in the present case to pass upon the amount, if any, now due to the State on its claim filed in the debtor's proceedings for taxes in arrears and the interest and penalties thereon. This involves, at the very threshold, passing upon the validity of the compromise made by the trustees on court order under the provisions of the Settlement Acts.

It will be impossible for the Commission or anyone else to prepare any plan of reorganization of this debtor, under Sec. 77, until the Bankruptcy Court exercises this jurisdiction and determines the questions herein presented.

POINT III

The compromise between the State and debtor's Trustees arising from the acceptance of the provisions of the Tax Settlement Acts is valid and enforceable (A) under Section 27 of the Bankruptcy Act; as well as (B) under New Jersey law.

(A) Under Section 27 of the Bankruptcy Act

Section 27 of the Bankruptcy Act of 1898 (U. S. C. A., Tit. 11, Sec. 50) provides:

> "The trustee may with the approval of the court, compromise any controversy arising in the administration of the estate upon such terms as he may deem for the best interests of the estate."

The term "any controversy" is broad enough to include controversies with municipalities, states and the federal government, as well as claims of individuals.

General Order No. 33 promulgated by this court provides:

> "Whenever a receiver, trustee or debtor in possession shall make application to the court for authority to submit to arbitration any controversy arising in the settlement of an estate, or for authority to compromise any such controversy, the application shall clearly and distinctly set forth the subject matter of the controversy, and the reasons why it is proper and for the best interests of the estate that the controversy should be settled by arbitration or compromise" 11 U. S. C. A., Sec. 53, p. 86.

There is ample judicial precedent for the action of the District Court in authorizing its trustees to accept the

offer of the State contained in the Tax Settlement Acts. Not only does the Court of Bankruptcy possess the power of a court of equity to settle controversies between the trustee and creditors or claimants, but there is express statutory authority which empowers the court to approve such settlements when "for the best interests of the estate".

Pullman Couch Co. v. *Eshelman* (4th Cir.), 1 Fed. (2d) 885;
Drexel v. *Loomis* (8th Cir.), 35 Fed. (2d) 800;
In re Riggi Bros. (2nd Cir.), 42 Fed. (2d) 174;
In re Van Camp Products Co. (C. C. A. 7th Cir.), 95 Fed. (2d) 206;
In re Prudence Co. (C. C. A. 2nd Cir.), 98 Fed. Rep. (2d) 559;
In re Kansas City Journal-Post Co. (C. C. A. 8th Cir.), 144 Fed. (2d) 816.

All of the above cases involve appeals from the order approving the settlement. In cases where the offeror has declined to go through with the settlement after approval, it has been held that the court has power by summary order to hold him to the performance of the compromise on the ground that by making his offer he has subjected himself to the jurisdiction of the court so far as the compromise is concerned.

In re Sobod Inc., 25 Fed. Supp. 344; aff'd. 103 Fed. (2d) 1096;
In re Hollingsworth & Whitney Co. (1st Cir.), 242 Fed. 753.

The case of a judicial sale is a fair analogy. A court which has ordered a sale of property in its care may order a defaulting purchaser to carry out the bargain he made.

Camden v. *Mayhew*, 129 U. S. 73;
In re Rival Knitting Co. (2nd Cir.), 289 Fed. 960.

Certainly there is no reason for having a different rule where the State is claimant in the Bankruptcy proceedings. In the case at bar the offer of compromise was made by the Legislature with the Governor's approval, which is the most solemn form of offer of compromise that a State could make. Moreover the State prior to the passage of the Tax Settlement Acts had entered the proceedings as a creditor and its verified claim was before the court for allowance and adjudication.

The Attorney General did not commence the information suit to attack the constitutionality of the Railroad Settlement Act of 1941 until after the court had made its order directing the trustees to accept the State's offer of compromise and the trustees had filed with the proper state officers their undertaking in writing to pay the principal of the defaulted taxes with 3% interest, and had also delivered the necessary discontinuances of pending actions and the certified checks, as required by the Statute. Furthermore, after the Attorney General in the Fall of 1941 filed his information suit, the next, or 1942 Legislature passed a law amending the 1941 Tax Settlement Act for the very purpose of curing any technical defects therein, and prescribing the exact form of undertakings and acceptance papers to be delivered, and eliminated the requirement that such papers be approved by the Attorney General.

Two successive Legislatures having passed Railroad Tax Settlement Acts which were approved by the Governor, the provisions of both of which laws were accepted by the trustees with court approval, there can be no doubt of the intention of the State to offer a compromise of the tax claims or of the acceptance thereof by the trustees with full and complete court approval. The only objector to this compromise is the Attorney General, whose duty in the premises is expressed in Paragraph 9 of both Settlement Acts, as follows:

"The Attorney General is hereby authorized *and directed* to execute in the name of the State of New Jersey any and all consents and approvals to a plan or plans of reorganization of a railroad corporation, under federal bankruptcy or other laws, to the extent that such plan provides for payments to the State on claims for taxes in accordance with the provisions of this act" (as amended by Section 9 of the 1942 Act).

(B) The Compromise is valid and enforceab.e under New Jersey Law.

The Railroad Tax Settlement Act of 1941 contains this provision:

"12. Effect of Unconstitutionality.

If any provision of this Act, or the application thereof to any person or circumstances, is held invalid, the remainder of this Act, or application of such provision to other persons or circumstances, shall not be affected thereby."

The same provision was contained in Sec. 15 of the Amendment of 1942.

Since, under New Jersey law,

"A decision based upon stipulated facts that results in declaring a law unconstitutional does not wipe the act from the statute books, but merely denies its efficacy to a party who has admitted the existence of a state of facts that in the opinion of the court renders the law unconstitutional" (Pitney, J., in *Rutten* v. *Paterson*, 73 N. J. L. 467, 475),

it follows that the separability clauses in the Tax Settlement Acts will operate to preserve to debtor's estate the benefits of said Acts.

40 Harvard Law Review, 626;
51 Harvard Law Review, 76.

Under the decisions of the New Jersey Court of Errors and Appeals, a duly enacted statute is not null and void, even though later declared unconstitutional, and actions taken in good faith under the statute are effective, certainly when taken prior to any challenge. *Allison* v. *Corker*, 67 N. J. L. 596; *Attorney General* v. *McGuinness*, 78 N. J. L. 346; *Eastwood* v. *Russell*, 81 N. J. L. 672; *In re Public Utility Board*, 83 N. J. L. 303, (1912).

In *Allison* v. *Corker, supra,* a statute, later declared unconstitutional, was accepted and acted upon. Subsequently it was amended and supplemented by an admittedly valid Act which corrected the original defect. The question was whether the supplemental Act cured the vice in the original Act and thus supported the acts already taken in reliance thereon. The Court of Errors and Appeals held the statute valid and effective. In so holding, the Court said (pp. 600-601):

> "But I am prepared to go further and hold that an unconstitutional statute is nevertheless a statute—that is, a legislative act * * *. The function of the judicial department, with respect to legislation deemed unconstitutional, is not exercised *in rem*, but always *in personam*. The Supreme Court cannot set aside a statute as it can a municipal ordinance. It simply ignores statutes deemed unconstitutional. For many purposes an unconstitutional statute may influence judicial judgment, where, for example, under color of it, private or public action has been taken. An unconstitutional statute is not merely blank paper. The solemn act of the legislature is a fact to be reckoned with. Nowhere has power been vested to expunge it or remove it from its proper place among statutes."

In *In re Public Utility Board, supra,* the Court said:

> "An act of the legislature, duly passed by both houses and approved by the governor, is presumably

a valid statute; and even though violative of some constitutional provision, it is not therefore null and void *ab initio*. As was said by Chief Justice Butler in *State* v. *Carroll*, 38 Conn. 449: 'Every law of the legislature, however repugnant to the constitution, has not only the appearance and semblance of authority but the force of law. It cannot be questioned at the bar of private judgment, and, if thought unconstitutional, resisted, but must be received and obeyed as, to all intents and purposes, law, until questioned and set aside by the courts. This principle is essential to the very existence of order in society.' The soundness of this doctrine is not in doubt in this state" (p. 306).

In *Chicot County Drainage District* v. *Baxter State Bank*, 308 U. S. 371, this Court overruled its earlier decision in the *Shelby County* case and said (Chief Justice Hughes):

> "The actual existence of a statute, prior to such a determination (of unconstitutionality) is an operative fact and may have consequences which cannot justly be ignored. The past cannot always be erased by a new judicial declaration. The effect of the subsequent ruling as to invalidity may have to be considered in various aspects—with respect to particular relations, individual and corporate, and particular conduct, private and official. Questions of rights claimed to have become vested, of status, of prior determinations deemed to have finality and acted upon accordingly, of public policy in the light of the nature both of the statute and of its previous application, demand examination."

See also *Phipps* v. *School District of Pittsburgh*, (C. C. A. 3d) 111 Fed. (2d) 393; *J. A. Dougherty's Sons* v. *Commissioner of Int. Rev.* (C. C. A. 3d) 121 Fed. (2d) 700.

In the New Jersey cases cited the action taken was before any challenge had been made. In *Attorney General* v. *McGuinness, supra,* the Court of Errors and Appeals indicated that the existence of a bare challenge does not vary the local New Jersey rule. In that case it said:

> "For such mistaken conception leads to the radical error that, if duly challenged, a legislative act will be sustained only when it is demonstrably constitutional. Such a notion in effect supplements the constitution by requiring the affirmative concurrence of all three departments of the government where that instrument of the organic law requires but two, viz., the legislative and the executive * * *."

The debtor's relinquishment of all further rights to contest in the State tribunals, whether by express waiver or by allowing time to lapse, was first made under authority of Order No. 123 responsive to the 1941 Settlement Act, at a time when no challenge and no notice of any contemplated challenge had occurred. The 1942 Act was amendatory of and supplemental to the 1941 Act, and Order No. 163, responsive to the 1942 Act, was necessary to preserve a change in status already made in reliance upon the earlier Act. Such a state of affairs justified, if, indeed, it did not require, the Bankruptcy Court to order compliance upon the principle that the legislative offer was the law of the state until declared unconstitutional. [See Order 163, R. 285, par. 5.]

Moreover, this Court has now held that a District Court, having the necessary jurisdiction over the parties and acting in the exercise of its equity powers, may determine the local law where, due to the situation existing, it is appropriate for it to do so. *Meredith et al.* v. *City of Winter Haven,* 320 U. S. 228. In the *Winter Haven* case, jurisdiction rested upon diversity of citizenship, while here it rests on the Bankruptcy Act. There the

circumstance which made a determination essential was the confusion existing in the decisions of the State Courts. Here the situation made a determination even more imperative, for the State decisions on the effectiveness of a statute even though later declared unconstitutional were clear, immediate action was necessary, and there was no dispute as to the meaning of the statute.

The concluding paragraph of the opinion of this Court in the *Winter Haven* case is apposite here:

> "Even though our decisions could not finally settle the questions of state law involved, they did adjudicate the rights of the parties with the aid of such light as was afforded by the materials for decision at hand, and in accordance with the applicable principles for determining state law. In this case, as in those, it being within the jurisdiction conferred on the federal courts by Congress, we think the plaintiffs, petitioners here, were entitled to have such an adjudication."

Wilentz v. *Hendrickson*, (*supra*) was decided on a stipulation of facts made between the State's Attorney General and Treasurer. The Court of Errors and Appeals held that the Tax Settlement Acts amounted to an appropriation of money to corporations in violation of Art. I, par. 20 of the State Constitution.

In reaching its conclusion the Court said (at p. 253):

> "Thus if the state has a vested right in and to the tax debt (delinquent interest), then unless the remission, cancellation and abatement of that right is supported by a 'legal, equitable or moral consideration' (In re Voorhees, 123 N. J. Eq., 142) the challenged statutes clearly contravene, in spirit and in fact, the Constitutional limitation (Art. I, par. 20) invoked."

Again, at page 260, the Court said,

"Nor do we find anything in the proofs to support a moral or equitable consideration."*

A trifling inconvenience to the one party or a slight advantage to the other is sufficient to constitute lawful consideration. *National Bank* v. *Bloom*, 113 N. J. L. 597, 602 (E. & A.). " 'Consideration' in the legal sense of the word, of a contract is the quid pro quo, that which the party to whom a promise is made does or agrees to do in exchange for the promise." *Phoenix Mutual Life Insurance Company* v. *Raddin*, 120 U. S. 183.

Restatement of the law of Contracts, Vol. I, Sec. 75 states:

"DEFINITION OF CONSIDERATION.

(1) Consideration for a promise is

(a) an act other than a promise, or
(b) a forbearance, or
(c) the creation, modification or destruction of a legal relation, or
(d) a return promise,
bargained for and given in exchange for the promise.

(2) Consideration may be given to the promisor or to some other person. It may be given by the promisee or by some other person."

At the time the Trustees on Court approval accepted the provisions of the Railroad Tax Settlement Acts and filed with the proper State Officers their undertaking to pay the taxes in arrears in the manner provided by the

* The Vice Chancellor in *Wilentz* v. *Hendrickson*, 133 N. J. Eq. at p. 483, stated that the debtor "is offered an abatement of $7,555,531.97 * * * as contrasted with potential savings on its then pending tax appeals of $5,951,395.86." The trustees discontinued such appeals in accepting the Settlement Acts.

Acts, and delivered to the State Treasurer their certified checks for the amounts due under the Acts, together with consents to the discontinuance of all pending appeals from assessment of taxes, it was the settled law in New Jersey that taxes and penalties in arrears due to the State might be compromised and also that the interest of 1% per month was a penalty and not a part of the tax.*

Town of Belvidere v. *Warren Railroad Co.*, 34 N. J. L. 193;
Dixon v. *Jersey City*, 37 N. J. L. 39;
Camden v. *Allen*, 26 N. J. L. 398;
Pennsylvania T. & T. Co. v. *Gummere*, 87 N. J. L. 353.

See also the powerful dissenting opinion of Justice Case in *Wilentz* v. *Hendrickson*, 135 N. J. Eq., at page 275.

It is, therefore, respectfully submitted (a) that *Wilentz* v. *Hendrickson* (*supra*) having been tried on an agreed state of facts is under New Jersey law binding only upon the parties to the information suit, namely, the Attorney General and the State Treasurer; (b) even under that decision, where legal, equitable or moral consideration supports the settlement between a taxpayer and the State it is valid and binding on the State; (c) under the Separability Clause in the Statute, the rights of any taxpayer entitled to the benefits of the Settlement Acts are fully preserved; and finally (d) the debtor and its trustees having given legal, equitable and moral consideration for their acceptance of the terms of the Settlement Acts are entitled to the benefits thereof under State law as well as under Section 27 of the Bankruptcy Act, 11 U. S. C. A. 50.

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* The State decisions after 1943 hold that the interest of 1% per month is not a penalty and becomes a part of the tax debt.

Wilentz v. *Hendrickson*, 135 N. J. E. 244 (1944);
State v. *Erie R. Co., et al.*, 23 N. J. Misc. 203 (1945).

The discussion under this point is presented to make clear to this Court the intricacies of the problems presented by the Trustee's petition for adjudication; to present the status of the Federal and New Jersey law; and to indicate that the issues involved are not *res adjudicata* under *Wilentz* v. *Hendrickson*, but must be determined under Federal Law.

POINT IV

There is a substantial question for decision as to whether the State has lost its alleged lien (A) By demanding and accepting payments on account out of Debtor's General Funds; (B) By repealing the statute which gave a lien and at the same time enacting a new law which attempts to preserve, change and extend the alleged lien; and (C) By accepting payments equal to the principal of taxes in default plus 3% interest from December 1, 1940 which, under the terms of the Settlement Act, discharged the lien.

A

We have shown in the statement of facts, pages 8 and 9 hereof, how the Attorney General several times appeared generally in the bankruptcy proceedings and requested payments on account of the taxes in arrears. The claim of the State of New Jersey asserted in paragraph 10 (R. 66):

> "The statute of New Jersey provides that these taxes shall be a lien paramount to all other liens upon all the lands and tangible property and franchises of the company in this State (Section 9, Chapter 208, P. L. 1888, as amended and supplemented; Section 54:27-4, Revised Statutes). The lien shall take effect on June 1 of the year in which the tax is payable."

Payments made by the debtor and Trustees to the State prior to the filing of the State's proof of claim appear under the item of collection in the schedule annexed to the proof of claim (R. 68-69).

Payments on account made after the proof of claim was verified, December 15, 1940, are shown, *supra*, at page 35.

The last payment of $15,250,000 was made May 6, 1946 (R. 318), pursuant to Order 333, dated April 26, 1946, consented to by the Attorney General (R. 296).

The total paid the State on account of its tax claims for the years 1932-1939 inclusive by the debtor and the trustees since bankruptcy aggregates $18,199,553. It is believed by the trustee that it will be ultimately determined that this amount is sufficient to have paid the State in full the principal amount of its taxes to December 1, 1940, and 3% interest thereon from December 1, 1940 to the date of payment in accordance with the provisions of the Railroad Tax Settlement Act.

While the State in its proof of claim made reference to its lien, this was required by Section 57 (c) of the Bankruptcy Act, 11 U. S. C. A. 93(c). There is no suggestion that the State intended to rely solely upon its lien. On the contrary, all of the indications were that the State deliberately chose not to rely on ultimate enforcement of its alleged lien but rather to secure with the aid of the Bankruptcy Court prompt payment by installments long ahead of the debtor's reorganization.

When the debtor filed its petition under Section 77 of the Bankruptcy Act, 11 U. S. C. A. 205, the State was confronted by a choice of remedies, and these remedies were inconsistent. If the State chose to rely primarily upon its alleged security it would have the burden of proving the validity and amount of its lien, and before realizing any tax money would have to wait until its alleged security was valued and any deficiency payable out of general assets was determined. On the other hand, if the State

wished to begin promptly collecting part of the disputed taxes it might waive its lien and file a proof of claim for the full amount of taxes and penalties *claimed*, shifting to the debtor's estate the burden of showing that the full amount claimed was not due. Confronted by these inconsistent remedies the State chose the latter (a) by filing its proof of claim *for the full amount of the taxes and penalties claimed* and (b) by requesting and accepting cash payments on account aggregating over $18,000,000 out of assets on which the First Mortgage Bondholders claimed to have a first lien.

Commenting on such a choice of remedies by a secured creditor, the Seventh Circuit Court, in *In re O'Gara Coal Co.*, 12 Fed. (2d) 426 (C. C. A. 7th; cert. den. 271 U. S. 683), said:

> "When one has two inconsistent remedies and elects to pursue one, he abandons the other. The remedies open to the receiver in this case were wholly inconsistent, and were to be secured by different lines of procedure. In the case of the proceeding as for an unsecured claim, the participation would be, as between the receiver and other creditors, upon the full amount of the claim. If the procedure was by the course to establish the balance of a secured claim, the participation would be only upon that balance. In bankruptcy, there have been many decisions in the District Courts, all to the effect, so far as we have found, that the consequence of filing a secured claim as an unsecured debt is the waiver of the security. *White* v. *Crawford* (C. C.), 9 F. 371; *In re M. I. Hibbler Machine Co.* (D. C.), 192 F. 741; *In re Fisk & Robinson* (D. C.), 185 F. 974; *In re Little* (D. C.), 110 F. 621, 627 (Judge Shiras); *In re Notris*, 18 Fed. Cas., page 316, No. 10,303; *In re High*, 12 Fed. Cas., page 133, No. 6,473; *In re Jaycox*, 13 Fed. Cas., page 409, No. 7,242; in which case it was held, however, that when such proof was made through ignorance or

mistake a creditor ought to be allowed to withdraw his proof and prove as a secured creditor; *In re Granger*, 10 Fed. Cas., page 958, No. 5,684."

To the same effect, see *In re Stineman*, 155 Fed. (2) 755 (certiorari granted October 14, 1946, No. 371, October Term), where the Third Circuit Court of Appeals recently held that creditors who had filed claims based upon judgment liens and then had accepted dividends out of general assets must be held to have waived their security because

"It is fundamental that the value of securities held by creditors must be valued before they may participate in distributions from the general estate and dividends may be paid only on the unpaid balances."

And the Court in applying the rule added that since the lien creditors

"have received dividends from the general estate to the full extent of their claims as allowed without having the value of their securities ascertained or deducted as provided by law* they must be deemed to have elected to be treated as general creditors and to have waived their rights to the security of their judgment liens. See *In re O'Gara*, 12 F. 2d 426, cert. den. 271 U. S. 683, and the cases cited therein; *Coggin* v. *Hartford Accident & Indemnity Co.*, 9 F. Supp. 785."

See also *Fisk & Robinson*, 185 Fed. 974; *Robinson* v. *Exchange National Bank of Tulsa*, 28 Fed. Supp. 244 (D. C. Okla., 1939); and *Butler* v. *Commonwealth Tobacco Co.*, 74 N. J. E. 423. In the latter case the New Jersey Court of Errors and Appeals, in an opinion contrasting

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* Sections 57h and 65a of the Bankruptcy Act, 11 U. S. C. A. 93(h) and 105(a).

the so-called bankruptcy rule with the equity rule, pointed out that the New Jersey Courts in both bankruptcy and insolvency cases have followed the "bankruptcy rule" consistently since 1835. In other words, for over 100 years the established rule in New Jersey has been that a secured creditor claiming against an insolvent debtor must either "waive his security and prove for the full amount of his debt or evaluate his security and prove for the difference."

In view of the above principles and precedents, it is submitted *first*, that the moving party in the present proceeding was the State itself, which invoked the jurisdiction of the Bankruptcy Court by filing its Proof of Claim; *second*, that no issue respecting the State's alleged lien has, as yet, been submitted to the Bankruptcy Court (except in the Trustee's petition for adjudication of August 14, 1944) and if any question respecting said lien should hereafter arise, it will be merely incidental to the State's tax claims which are now at issue (*Coder* v. *Arts*, 213 U. S. 223); and *third*, since the State elected to file its claim for the full amount alleged to be due, instead of for any deficiency over and above the value of its alleged lien, and has accepted large payments out of general assets on account of said claim, it has waived any lien it might have relied upon.

B

The State's Proof of Claim for taxes asserts a lien under par. 10, Sec. 9, Ch. 208, P. L. 1888, as amended and supplemented; Sec. 54:27-4, Revised Statutes, N. J.

This section of the statute, which was a part of the Railroad Tax Act, provides:

"54:27-4. Default; penalty; remedies; liens.

"If the taxes of any company, or any part thereof, remain unpaid on December 1st following the levying thereof, the company shall be considered in default, and such taxes, or the unpaid portion thereof, shall thenceforth bear interest at the rate of one percent for each month until paid. Notwithstanding the prosecution of a writ of certiorari or other remedy the taxes shall be a lien paramount to all other liens upon *all the lands and tangible property and franchises of the company in this State.* The liens shall take effect on *June 1st* of the year in which the tax is payable and shall be a debt due from the company to the State on that date for which an action at law or suit in equity may be maintained, and shall be a preferred debt in case of insolvency. These remedies are in addition to the special proceedings provided for in Chapters 19 to 29 of this Title (Sec. 54:19-1, et seq.)."

The above section was repealed by Section 75, Chapter 291, P. L. 1941* (Rev. 54:29A-75 (Pamphlet)), (New Tax Act).

The New Tax Act contains the following provisions:

"54:29A-53. Interest. Taxes heretofore imposed pursuant to any law for the taxation of property used for railroad and canal purposes, or hereafter imposed pursuant to this Act, or any unpaid portion thereof, shall bear interest from and after the date upon which they became or may become due and delinquent at the rate of one percentum (1%) for each month until paid notwithstanding the prosecution of a writ of certiorari or other remedy."

"54:29A-54. Lien of Taxes. The taxes imposed by this Act or heretofore imposed pursuant to any act for the taxation of property used for railroad and

* A copy is in the Appendix annexed.

canal purposes, shall be and remain a lien paramount to all other liens *upon the revenues and all the real and personal property owned, used or controlled by the taxpayer within this State.* The lien shall take effect as of the *1st day of the year* in which the tax is payable."

"54:29A-55. Tax a debt; preference. The taxes imposed by this Act or heretofore imposed shall be and remain a debt due from the taxpayer to the State for which an action at law or suit in equity may be maintained and shall be a preferred debt in case of insolvency."

A comparison of the old and the new sections of the Tax Laws shows an attempt to extend the lien of the State to assets of the debtor and other railroads that were not covered by the old law. The State now contends that its lien extends to "the *revenues* of the debtor", and to "personal property *controlled* by the debtor", assets which were not subject to the State's alleged lien prior to 1941.

We know of no authority for a creditor, whether it be a State or mortgagee, to change and extend a lien on a bankrupt's property after a petition in bankruptcy has been filed. Upon the filing of the petition in bankruptcy the rights of the bankrupt, or debtor, creditors and stockholders, became fixed.

Straton v. *New*, 283 U. S. 318.

What happened to the lien asserted by the State under the old law, in existence when the petition was filed by the debtor, when the State passed the 1941 Tax Act, Chap. 291 which in Section 75 expressly repealed the former law under which the taxes in question were assessed and the liens created?

Were such liens effectually preserved by Section 74, Chap. 291* of the repealing act, which stated:

> "Nothing herein shall be construed to * * * repeal, abate, cancel, cause to lapse or otherwise affect in any manner any assessment or the lien or obligation to pay any taxes heretofore assessed * * * or the legal authority to collect taxes, interest and penalties which have accrued under any provision of law repealed by this act, or under any other law, *except as specifically provided in this act.*"

It would seem that the purpose of the last clause was to hold the old lien and yet extend it to cover assets not covered by the original lien.

We have no doubt that if a mortgagee, after a petition in bankruptcy had been filed against an individual or corporate debtor, had cancelled his mortgage and simultaneously had taken and recorded from the bankrupt a new mortgage covering property in addition to that covered by the original mortgage, it would be held that the lien of the cancelled mortgage was extinguished even though the new mortgage contained the provision that it "shall be and remain a lien paramount to all other liens" on the property of the bankrupt. We know of no authority sustaining the right of a State to alter and extend its lien after a Court of Bankruptcy had obtained jurisdiction by repealing the old and enacting a new law in the manner indicated.

It would seem that, with all the facts considered, the State has elected to rely on its claim as a preferred claim and by its conduct lost its lien.

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* See copy in Appendix annexed.

C

The Tax Settlement Act of 1941 (Chapter 290), in Section 5, provides:

> "Discharge of Lien. The liens of the State for taxes and interest penalties of each year for which delinquent taxes are payable pursuant to this act shall be fully satisfied and discharged, in the order in which such taxes accrued, when and as principal payments on account thereof equal or exceed the full principal amount delinquent for any tax year, and interest upon all unpaid balances has been paid in full."

Section 4 provides:

> "Interest. All interest penalties upon taxes paid pursuant to this act shall be abated and cancelled, except that, in addition to installment payments, interest at the rate of three per centum (3%) per annum shall be paid annually upon the balance of delinquent taxes remaining unpaid from and after December first, one thousand nine hundred and forty."

Since the amount of the principal of the State's tax claims in default for the years 1932-1939 inclusive as shown in the Proof of Claim (R. 64) was $12,117 450.64, and the Trustee has paid the State $18,199,553 under court orders it would seem that all of the defaulted taxes with interest at 3% per annum has been paid in full.

However, if it should be determined that the compromise of the State's tax claims was not dispositive of the issues presented a resulting question which will have to be determined in the reorganization proceedings is the application of the payments aggregating $18,199,553 that have been made by the Trustee on account to the State. Another equally important question for determination will be whether under all of the facts and cir-

cumstances the State is entitled to interest at 3% per annum, from December 1, 1940, in accordance with the Tax Settlement Acts, or at 1% per month from the several dates of annual assessment as the State contends. If the interest is at 1% per month the State claims that there will be an additional amount payable to the State of approximately $15,000,000. If any such amount is determined to be payable to the State a very serious question of application of amounts already paid as between principal and interest will immediately arise because certain of the payments made were, by order of the Bankruptcy Court, specifically applicable to principal, whereas under the recent decision of Judge Oliphant in *State* v. *Erie Railroad Co.*, 23 Misc. Reps. 203 (June 11, 1945),

> "• • • every dollar of tax was intended to carry its own interest burden in the event that such dollar of tax should be in default.
>
> "To explain—let us suppose that $1,000,000 of taxes are in default and a railroad company wishes to pay $100,000 on account. At the time of the payment of the $100,000, the Comptroller must divide that sum into two component parts so that one of them will represent interest at the statutory rate on the other for the period of the delinquency. The interest component will then be deductible from the balance of interest owing at the time the payment is made and the principal component will be deductible from the balance of principal owing at that time. The mathematical formula for accomplishing this result is feasible and easy of application. Any payment heretofore made by the railroad companies subsequent to default must be so adjusted as to accomplish this result."

The mere statement of these questions that are involved in and raised by the Trustee's petition for adjudication of the State's claims emphasizes the error of the Circuit Court of Appeals in holding that the only matters

left open for the Bankruptcy Court to pass upon are (1) mathematical error in the computation of the amount of the tax, or (2) legal error in its assessment, and reversing Order No. 271, which confirmed the interim report of the Master which was to the effect that the Bankruptcy Court had jurisdiction to determine these questions.

It is the duty and within the exclusive jurisdiction of the Bankruptcy Court to inquire into the validity of claims, marshal them and control and enforce their liquidation and make application of the moneys already paid on the claim by the Trustees pursuant to court order.

Straton v. *New, supra;*
Isaacs v. *Hobbs Tie & Timber Co., supra.*

Order No. 333 (R. 296) under which the Trustee paid $15,250,000 in cash to the State on account of its tax claims contained this provision:

> "(a) in the event that the claims of the State of New Jersey shall be finally determined to be an amount greater than said payment, said payment shall be deemed to have been applied in satisfaction of said claims, as finally determined, for each of the years commencing with 1940 and extending back through each of the preceding years and portion thereof that said payment shall be sufficient therefor, provided that with respect to any year for which such payment shall be sufficient to satisfy only a portion of the claim the application shall be deemed to have been made ratably as between the principal amount of the tax and the interest thereon, at the rate finally determined, computed to the date of said payment; and provided further, that if it shall be finally determined that this Court may direct the application of said payment solely to the satisfaction of the principal amount of said claims, the application of said payment shall be deemed to have been made solely in satisfaction of said principal amount" (R. 297).

Paragraph 2 provided:

> "Except as otherwise provided in paragraph 1 of this order, the making of said payment by the Trustee and the acceptance thereof by the State of New Jersey shall be without prejudice to the rights of or the positions asserted by either of them or any party hereto in litigation now or hereafter pending relating to said claims of the State of New Jersey" (R. 298).

For all of the above reasons the question as to what lien, if any, the State now has is wholly unsettled. This question is of paramount importance because, obviously, since the Debtor has outstanding an issue of $50,000,000. of General Mortgage Bonds on which interest has been unpaid since April 1939 and the amount and validity of this lien is unquestioned, the priority questions involved must be decided before any plan of reorganization can be devised.

CONCLUSION

It is respectfully submitted that the judgment of the Circuit Court of Appeals should be reversed; and that the cause should be remanded with instructions to the District Court that it has exclusive jurisdiction to determine every question presented by the Trustee's petition for an adjudication regarding the State's claims.

November 6, 1946

Respectfully submitted,

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APPENDIX

Chapter 290, Laws of 1941 (N. J.)

AN ACT relating to the collection of certain delinquent taxes upon railroad companies.

WHEREAS, Certain taxes levied for the years 1932 through 1940 upon property used for railroad purposes in this State are delinquent and unpaid, and the total accumulated delinquencies, exclusive of interest penalties, amounted to more than thirty-four million dollars ($34,000,000.00) as of December thirty-first, one thousand nine hundred and forty; and

WHEREAS, Four of the railroad systems serving this State are or have recently been in reorganization under Federal bankruptcy laws, and there is serious doubt as to the ability of the railroads operating in the State to pay the delinquent taxes, and at the same time to continue to furnish adequate and safe service; and

WHEREAS, The limited area of New Jersey and its intensive industrial development make it peculiarly dependent upon efficient transportation, particularly because of the present demands of production for national defense, and immediate payment of accumulated tax delinquencies would impair the capacity of the delinquent railroads to furnish adequate and safe service; and

WHEREAS, The unpaid railroad taxes have tended to create a chaotic condition in State and municipal finances, and the entire State has an urgent and important interest in the immediate solution of the question of delinquent railroad taxes and in the maintenance of stable transportation facilities and public finances; now therefore,

BE IT ENACTED *by the Senate and General Assembly of the State of New Jersey*:

1. Installment payments. The State Treasurer is hereby authorized and required to accept, without interest penalties, installment payments of the full principal amount of property taxes upon railroad companies, which were due on or before December first, one thousand nine hundred and forty, and remain unpaid on the effective date of this act. But the State Treasurer shall not accept any installment payments under the terms of this act unless and until the delinquent taxpayer shall have complied with the requirements of sections seven and eight hereof.

2. Maximum period. The total principal amount of delinquent taxes payable under this act shall be paid in full, in accordance with the respecti capacity to pay of each railroad system and of each railroad company not part of a system, within a maximum period from and after December first, one thousand nine hundred and forty, determined as the whole number of years next greater than seven times its "burden index," computed as hereinafter set forth, except that each taxpayer shall be allowed at least two years, and no taxpayer shall be allowed more than twenty years.

The burden index shall be determined for each railroad system, and for each company not part of a system, by dividing its total amount of delinquent taxes as of December thirty-first, one thousand nine hundred and forty, by the five-year average of its net railway operating income, for the years one thousand nine hundred and thirty-six through one thousand nine hundred and forty, inclusive. Any system or railroad not part of a system whose average net railway operating income is not a positive sum shall be allowed the maximum period of twenty years.

For the purpose of this act, a railroad system shall be deemed to consist of an operating railroad reporting to

the Interstate Commerce Commission for the year one thousand nine hundred and forty and all the companies included in its report of system operations.

3. Date and amount. Installment payments shall be made on or before December first in each year. Each annual installment shall be not less than such amount as, together with all prior installment payments, shall leave a balance remaining due the ratio of which to the total principal amount of delinquent taxes payable hereunder shall not exceed the ratio of the number of unexpired years to the total number of years of the maximum period permitted under section two of this act.

4. Interest. All interest penalties upon taxes paid pursuant to this act shall be abated and cancelled, except that, in addition to installment payments, interest at the rate of three per centum (3%) per annum shall be paid annually upon the balance of delinquent taxes remaining unpaid from and after December first, one thousand nine hundred and forty.

5. Discharge of lien. The liens of the State for taxes and interest penalties of each year for which delinquent taxes are payable pursuant to this act shall be fully satisfied and discharged, in the order in which such taxes accrued, when and as principal payments on account thereof equal or exceed the full principal amount delinquent for any tax year, and interest upon all unpaid balances has been paid in full.

6. Liens preserved. The remedies of the State for the collection of delinquent taxes payable pursuant to the provisions of this act shall not be enforced against any taxpayer which enters upon the execution of an installment payment plan hereunder, in the manner provided by sec-

tion seven hereof, so long as installment payments and interest upon the unpaid balances continue to be paid on or before the respective due dates. Upon default in payment of all or part of an installment payable in any year or of interest upon the unpaid balance, the whole remaining amount of delinquencies including interest penalties, shall, subject to the provisions of section five of this act, be reinstated and become due and payable thirty days after the date of default. Nothing in this section shall be construed to deprive any taxpayer of credit for installment payments upon the principal amount of delinquencies made prior to such default.

7. Undertaking; first payment. Any railroad or system, or the receiver, trustee or trustees thereof, may enter upon the execution of an installment payment plan authorized under this act by (1) duly executing and filing with the State Comptroller a written undertaking, in such form as the Attorney-General shall prescribe, for the payment of the total amount of delinquent taxes owed by the railroad or system and (2) paying into the State treasury an amount not less than the first annual installment together with interest on the unpaid balance computed in the manner provided by sections two, three and four of this act.

8. Waivers. The first payment tendered pursuant to this act shall be accompanied by a waiver of any and all rights to contest the legality or amount of any assessment made prior to December first, one thousand nine hundred and forty-one, together with stipulations, consents or other papers for the discontinuance and dismissal of all suits, actions, and proceedings pending in any court or before the Board of Tax Appeals concerning such assessments, all in such form as the Attorney-General may require.

9. Consents in reorganizations. The Attorney-General is hereby authorized and directed to execute in the name of the State of New Jersey any and all consents to a plan or plans of reorganization of a railroad corporation, under Federal bankruptcy or other laws, to the extent that such plan provides for payments to the State on claims for taxes in accordance with the provisions of the act.

10. Construction. Nothing in this act shall be construed to affect the payment and collection of taxes other than assessments made under chapters nineteen to twenty-nine of Title 54 of the Revised Statutes; nor shall any provision of this act be construed to authorize or recognize any claim for any refund, return or credit of all or part of the taxes of any company heretofore paid for any year.

11. Distribution of receipts. The monies collected by the State Treasurer pursuant to this act shall be subject to distribution, apportionment or appropriation as heretofore provided by law. The State Treasurer shall credit receipts hereunder to delinquent accounts in the order in which the delinquent taxes were originally assessed.

12. Effect of unconstitutionality. If any provision of this act, or the application thereof to any person or circumstances, is held invalid, the remainder of this act, or application of such provision to other persons or circumstances, shall not be affected thereby.

13. Effective date. This act shall take effect immediately.

Approved July 22, 1941.

Chapter 241, Laws of 1942 (N. J.)

AN ACT to amend the title of "An Act relating to the collection of certain delinquent taxes upon railroad companies," approved July twenty-second, one thousand nine hundred and forty-one (1941, c. 290) so that the same shall read "An act providing for the collection of unpaid taxes heretofore assessed upon property used for railroad purposes, for any or all of the years one thousand nine hundred and thirty-two to one thousand nine hundred and forty, inclusive, and also providing for the remission of unpaid interest penalties with respect to taxes heretofore assessed upon such property for any or all of said years," and to amend the body of said act and to supplement said act.

BE IT ENACTED *by the Senate and General Assembly of the State of New Jersey:*

1. The title of "An act relating to the collection of certain delinquent taxes upon railroad companies," approved July twenty-second, one thousand nine hundred and forty-one (1941, c. 290) is amended to read "An act providing for the collection of unpaid taxes heretofore assessed upon property used for railroad purposes, for any or all of the years one thousand nine hundred and thirty-two to one thousand nine hundred and forty, inclusive, and also providing for the remission of unpaid interest penalties with respect to taxes heretofore assessed upon such property for any or all of said years."

2. Section one of the act of which this act is amendatory and supplementary is amended to read as follows:

1. Any railroad taxpayer desiring to accept the provisions of this act shall, on or before June fifteenth, one

thousand nine hundred and forty-two, file with the State Treasurer the acceptance document required by this act, providing for the payment in full of the principal amount of all of its unpaid taxes for the tax years involved at the times and in the manner provided by this act and waiving any and all rights to contest the legality or amount of any assessment on its property used for railroad purposes made prior to December first, one thousand nine hundred and forty-one pursuant to the applicable tax acts, and of any assessment heretofore or hereafter made for the tax year one thousand nine hundred and forty-one; and shall also file with the State Treasurer a written consent to the discontinuance and dismissal of any and all suits, actions and proceedings pending in any court or before the State Board of Tax Appeals respecting any such assessments; and shall also at the same time pay to the State Treasurer the initial payment provided for by this act. The State Treasurer is hereby authorized and required to accept payment of such unpaid taxes when made in accordance with the terms of this act.

3. Section two of the act of which this act is amendatory and supplementary, is amended to read as follows:

2. The total principal amount of unpaid taxes payable under this act shall be paid in full, and such payment may be made in installments as herein provided, in accordance with the respective capacity to pay of each railroad system and of each railroad company not part of a system, within a maximum period from and after December first, one thousand nine hundred and forty, which shall be the whole number of years next greater than seven times its "burden index," computed as hereinafter set forth, except that each taxpayer shall be allowed at least two years, and no taxpayer shall be allowed more than twenty years.

The burden index shall be computed for each railroad system, and for each company not part of a system, by dividing its total amount of unpaid taxes as of December thirty-first, one thousand nine hundred and forty, by the five-year average of its net railway operating income, for the years one thousand nine hundred and thirty-six through one thousand nine hundred and forty, inclusive. Any system or railroad not part of a system whose average net railway operating income is not a positive sum shall be allowed the maximum period of twenty years.

4. Section three of the act of which this act is amendatory and supplementary is amended to read as follows:

3. The initial payment to be made under this act shall be made on or before June fifteenth, one thousand nine hundred and forty-two, and shall be an amount not less than the first annual installment computed as herein provided. After the payment of the initial installment on or before June fifteenth, one thousand nine hundred and forty-two, as required by this act, an additional installment payment shall be made on or before December first, one thousand nine hundred and forty-two, and in each year thereafter on or before December first of said year. Each such annual installment shall be not less than such amount as, together with all prior installment payments, shall leave a balance remaining due the ratio of which to the total principal amount of unpaid taxes payable hereunder shall not exceed the ratio of the number of unexpired years to the total number of years of the maximum period permitted under this act.

All such unpaid taxes shall bear interest at the rate of three per centum (3%) per annum, to be calculated from and after December first, one thousand nine hundred and forty. The initial payment shall include such interest to the date of such payment; and each subsequent payment

shall include interest at such rate on the unpaid balance of taxes calculated from the date of the next preceding installment payment. Any railroad taxpayer may, however, at the time or times herein specified for the payment of any installment of such taxes, pay the whole amount of taxes then remaining unpaid, together with the interest thereon as herein provided for, or it may at such time or times make payments in amounts in excess of the required installment payments, together with interest as provided in this act; or such taxpayer may make payment of any installment of taxes payable under this act in advance of the time or times specified by this act, together with the interest accrued to the date of such payment; and in any of such events, further interest shall cease with respect to the amount of the taxes so paid from the date of the payment thereof. Payments made by any railroad taxpayer shall be applied first to the payment of interest at three per centum (3%) per annum as provided by this act, and the amount of any payment in excess thereof shall be applied to the unpaid taxes owing by such taxpayer, in the order in which such taxes became payable under the applicable tax acts.

Should any railroad taxpayer so direct in the acceptance document filed pursuant to this act, the State Treasurer is hereby authorized and required to collect the amount of any drafts or checks, heretofore delivered to him by such railroad taxpayer in attempted compliance with the provisions of pamphlet laws of one thousand nine hundred and forty-one, chapter two hundred ninety, and to credit the same to the payments required to be made by such taxpayer under this act. If the amount of any such draft or check is less than the amount of taxes and interest required to be included in the initial payment, such taxpayer at the time of filing its acceptance document shall pay the balance of the initial payment required by this act.

5. Section four of the act of which this act is amendatory and supplementary is amended to read as follows:

4. Upon the acceptance of the provisions of this act by any railroad taxpayer, and as long thereafter as such railroad taxpayer shall make payment of the unpaid taxes and interest required by this act, there is and shall be stayed and suspended any remedy or proceedings to collect any unpaid taxes for the tax years one thousand nine hundred and thirty-two to one thousand nine hundred and forty, inclusive, and any statutory interest penalties with respect to any taxes assessed for said years.

6. Section five of the act of which this act is amendatory and supplementary is amended to read as follows:

5. Whenever any railroad taxpayer accepting the provisions of this act heretofore has paid, or hereafter shall have paid, as required by this act, the full amount of all taxes assessed upon its property used for railroad purposes for the years one thousand nine hundred and thirty-two to one thousand nine hundred and forty, inclusive, and all interest, if any, required by this act, such taxpayer and its property shall be released and discharged from any and all claims for statutory interest penalties with respect to any and all taxes assessed against such taxpayer or upon its property used for railroad purposes for any and all of the tax years one thousand nine hundred and thirty-two to one thousand nine hundred and forty, inclusive.

7. Section six of the act of which this act is amendatory and supplementary is amended to read as follows:

6. Upon default in the making of any payment provided for in the acceptance document, and a continuance thereof for a period of thirty days after the due date of

such payment, the then remaining unpaid balance of taxes, together with statutory interest penalties with respect to any and all taxes assessed against such taxpayer or upon its property used for railroad purposes for any of the years one thousand nine hundred and thirty-two to one thousand nine hundred and forty, inclusive, calculated from the original due date of such taxes shall immediately become due and payable, and the State may assert, exercise and enforce any and all rights, claims, demands, liens and privileges with respect thereto as if this act had not been enacted, and in addition thereto may assert and enforce any remedies it may have acquired under such acceptance document except that such taxpayer shall be entitled to a credit against such statutory interest penalties in an amount equal to the interest paid pursuant to the provisions of this act.

8. Section seven of the act of which this act is amendatory and supplementary is amended to read as follows:

7. The acceptance document herein referred to shall be in substantially the following form:

ACCEPTANCE AND WAIVER

The (insert name of railroad or system) does hereby accept the provisions of (insert the amended title of this act), and hereby undertakes and agrees to pay to the State of New Jersey in the manner and at the times prescribed by said act the sum of (insert total amount of taxes unpaid on December 1, 1940), being the total principal amount of taxes remaining unpaid on December 1, 1940, which were theretofore assessed against or levied upon the property used for railroad purposes for the years 1932 to 1940, inclusive, of the (insert name of railroad or system) together with interest thereon, to be computed at the rate of three per centum (3%) per annum from and after December 1, 1940.

(If any railroad taxpayer has heretofore delivered or tendered a draft or check to the State Treasurer on account of any part of such taxes or interest in attempted compliance with the provisions of P. L. 1941, chapter 290, the following clause may be added) "and said (insert name of railroad or system) does hereby authorize and direct the State Treasurer of New Jersey to retain and accept the draft or check heretofore delivered to him on the ..... day of ....., 1941, in the amount of ..... dollars, and to collect and credit the same upon the initial payment required to be made by this act."

And said (insert name of railroad or system) for itself and the following companies whose railroads are included in its system, to wit (list of companies) does hereby waive any and all rights under the laws of the State of New Jersey and of the United States to contest the legality or amount of any assessment upon its or their property used for railroad purposes made prior to December 1, 1941, pursuant to the applicable tax acts and of any assessment heretofore or hereafter made for the tax year 1941.

In Witness Whereof said (insert name of railroad or system) has caused this instrument to be sealed with its corporate seal and attested by its officers thereunto duly authorized, this ..... day of ....., 1942.

(Seal)

(Signatures)

9. Section eight of the act of which this act is amendatory and supplementary is amended to read as follows:

8. The consent to the discontinuance and dismissal of pending appeals and litigation shall be in substantially the following form:

Appendix

DISCONTINUANCE AND DISMISSAL

(Name of Court or tribunal)

(Names of parties to proceeding)

In re Assessments for (insert tax year)

On motion of (insert name of taxpayer or appellant) it is on this day of , 1942

Ordered that the appeal (or other proceeding) with respect to the taxes and assessments of the property of (insert name of taxpayer or appellant) used for railroad purposes for the tax year be and the same is hereby discontinued and dismissed.

We consent to the foregoing order.

(Signature of attorney for taxpayer or appellant)

10. Section nine of the act of which this act is amendatory and supplementary is amended to read as follows:

9. The Attorney-General is hereby authorized and directed to execute in the name of the State of New Jersey any and all consents and approvals to a plan or plans of reorganization of a railroad corporation, under Federal bankruptcy or other laws, to the extent that such plan provides for payments to the State on claims for taxes in accordance with the provisions of this act.

11. Section ten of the act of which this act is amendatory and supplementary is amended to read as follows:

10. Nothing in this act shall be construed to affect the payment and collection of taxes other than assessments made under the applicable tax acts; nor shall any provi-

sion of this act be construed to authorize or recognize any claim for any refund, return or rebate of any part of any taxes of any company heretofore paid for any year by any railroad or system.

12. Section eleven of the act of which this act is amendatory and supplementary is amended to read as follows:

11. The moneys collected by the State Treasurer pursuant to this act shall be subject to distribution, apportionment or appropriation as heretofore provided by law.

13. The act of which this act is amendatory and supplementary is supplemented by adding the following section:

14. As used in this act:

(a) The phrase "tax years involved" is defined to mean any or all of the years one thousand nine hundred and thirty-two to one thousand nine hundred and forty, both inclusive.

(b) The phrase "applicable tax acts" is defined to mean all statutes providing for the assessment and collection of taxes on property used for railroad purposes in effect for any or all of the tax years involved.

(c) The phrase "railroad taxpayer" is defined to mean any railroad system or railroad not part of a system owning or operating a railroad in this State, or the duly appointed and qualified receiver, receivers, trustee or trustees thereof, whose property used for railroad purposes has been assessed for taxes for any of the tax years involved, pursuant to the applicable tax acts as herein defined.

(d) The phrase "statutory interest penalty" is defined to mean the one per centum (1%) per month charges provided by the applicable tax acts or by any other act to be collected in the event of the failure to pay the taxes assessed under the applicable tax acts at the times specified therein.

(e) The word "interest" is defined to mean the interest at three per centum (3%) per annum provided to be paid by this act.

(f) The phrase "acceptance document" is defined to mean the instrument referred to in section seven of this act.

(g) The phrase "railroad system" is defined to mean an operating railroad company reporting to the Interstate Commerce Commission for the year one thousand nine hundred and forty and all companies included in its report of system operations.

14. The act of which this act is amendatory and supplementary is supplemented by adding the following section:

15. The purpose and object of this act is to provide for the payment by railroad taxpayers of unpaid balances of taxes assessed for the tax years involved, pursuant to applicable tax acts, upon property used for railroad purposes in this State, and to that end, it is hereby determined and declared:

Beginning with the year one thousand nine hundred and thirty-two and continuously thereafter, this State, at great expense and with considerable interruption to the orderly disposition of other tax review proceedings by State tribunals, has been engaged in litigation concerning

the validity and amount of assessments upon property used for railroad purposes in this State; and litigation involving substantial amounts of taxes and debatable questions of law and fact relating thereto are still pending and undetermined for certain of the tax years involved.

The development of competitive transportation facilities, the more general use of fuels other than coal, the shrinkage of export rail traffic destined to the Port of New York, the decentralization of industry and other causes, as well as the economic depression of the past decade, adversely affected the financial position and progress of the railroads operating in New Jersey, and although the income of such railroads was substantially decreased from former levels, the tax obligations of such railroads were not materially reduced.

The statutory interest penalty provisions of the applicable tax acts have not proven effectual to accomplish their purpose of assuring prompt payment of taxes, and unpaid balances of taxes for the tax years involved now exceed in the aggregate thirty-four million dollars ($34,000,000.00), exclusive of any claims of the State for statutory interest penalties relating to taxes assessed for the tax years one thousand nine hundred and thirty-two to one thousand nine hundred and forty, inclusive.

The prosecution of statutory legal proceedings under the applicable tax acts to enforce collection of unpaid balances of taxes and statutory interest penalties for the tax years involved has been accompanied by the institution and prosecution by certain railroad taxpayers of appropriate proceedings under Federal bankruptcy laws, resulting in the appointment of receivers or trustees of certain of such railroad taxpayers and their properties. Several railroad taxpayers of this State, whose taxes are in part unpaid, are now involved in such proceedings. It is probable that similar proceedings may be undertaken

with respect to other railroad taxpayers and their properties if existing statutory collection proceedings are continued or new proceedings instituted.

Whatever claims for unpaid taxes and statutory interest penalties have been filed on behalf of the State in such bankruptcy proceedings, the provability of the amount of the claims of the State has been questioned and objections have been filed by the receivers or trustees in reorganization to the allowance thereof. Litigation arising in connection therewith is pending in various Federal courts in which the bankruptcy proceedings are pending.

The delay and uncertainty in the collection of the unpaid balances of railroad taxes has created a chaotic condition in State and municipal finances and such tax moneys are urgently needed to pay existing and potential costs of government. It is imperative that a substitute and more effective and feasible method for the collection of such unpaid balances of taxes be provided promptly.

To meet the existing national emergency and aid the effective movement of armed forces and supplies, so that this State and the nation may be protected, it is essential that the railroads in this State be not financially harassed by the continued attempt to collect statutory interest penalties with respect to the taxes assessed for the tax years involved.

For more than fifty years last past, it has been the well recognized and approved public policy and practice of this State and its various agencies and subdivisions to meet financial emergencies resulting from long periods of financial depression by compromising, adjusting, abating and altering the amount and method of payment of obligations of taxpayers.

This Legislature has given consideration to investigations, recommendations, hearings and reports made by various public officials, legislative and other committees,

both during the current legislative year and prior thereto, in the matter of taxes assessed on property used for railroad purposes, and has particularly given consideration to a report on the subject made by the Joint Legislative Committee constituted by Senate Concurrent Resolution No. 8 of the one thousand nine hundred and forty-one Legislature, and a report dated February twenty-second, one thousand nine hundred and forty-one, made by a citizens committee appointed by His Excellency, Charles Edison, Governor of this State.

Certain railroad taxpayers have heretofore attempted to accept the provisions of this act as originally enacted, and as a result thereof, the State Treasurer now has in his possession drafts and checks in an amount in excess of ten million dollars ($10,000,000.00). Questions having arisen respecting the validity and construction of this act as originally enacted, such funds may not be presently available for use by either the State or its various agencies and municipalities. Should changes in financial status result in such drafts or checks becoming uncollectible, or should some or all of such railroad taxpayers undertake to withdraw such drafts or checks and all instruments filed in attempted compliance with said act, serious legal and financial questions may arise as to the rights of the State.

This Legislature has also considered the report made to it by its committee appointed pursuant to Senate Concurrent Resolution No. 2 of the one thousand nine hundred and forty-two Legislature.

After due deliberation and consideration, it is determined and concluded that the existing claims, controversies and litigation above mentioned can best be disposed of, and that the unpaid balances of taxes assessed upon property used for railroad purposes for the tax years involved can best and most quickly be collected, in the

manner and upon the terms and conditions herein provided, and that upon the acceptance of, and compliance with, such terms and conditions by any railroad taxpayer the State will have received full, fair and adequate consideration, and the best interests of the State will have been served and furthered.

15. If any provision of this act or the application thereof to any person or circumstances is held invalid, the remainder of this act, or the application thereof to other persons or circumstances, shall not be affected thereby.

16. This act shall take effect immediately.

Approved May 21, 1942.

Excerpts from Chapter 291, Laws of 1941 (N. J.) (New Tax Act)

CHAPTER 291

AN ACT relating to taxation of railroads, and repealing chapters nineteen through twenty-nine, inclusive, of Title 54 of the Revised Statutes, chapter ninety-one of the laws of one thousand eight hundred and eighty-five, chapter two hundred seventy-five of the laws of one thousand eight hundred and eighty-six, chapter three hundred thirty-three of the laws of one thousand nine hundred and twenty-one, and chapter four hundred twenty-three of the laws of one thousand nine hundred and thirty-three.

ARTICLE II

7. Property taxable; rate. There is hereby levied an annual property tax upon all property used for railroad

purposes at the rate of three per centum (3%) upon the true value thereof. The tax hereby imposed shall be assessed by the State Tax Commissioner, in the manner hereinafter provided, for the year one thousand nine hundred and forty-one and for each year thereafter.

• • •

13. Franchise excise. An annual excise tax is hereby levied upon all railroads operating within this State for the privilege of exercising their respective franchises, to be computed in the manner hereinafter provided. This tax shall be in lieu of any other tax or taxes of or upon such franchises.

ARTICLE VIII

54. Lien of taxes. The taxes imposed by this act or heretofore imposed pursuant to any act for the taxation of property used for railroad and canal purposes shall be and remain a lien paramount to all other liens upon the revenues and all the real and personal property owned, used or controlled by the taxpayer within this State. The lien shall take effect as of the first day of the year in which the tax is payable. L. 1941, c. 291, p. 791, §54.

• • •

ARTICLE X

74. Construction; other taxes. All other State and local taxes of or upon franchises or property used for railroad purposes, which may have been assessed for the first year in which this act becomes effective upon any taxpayer subject to taxation hereunder prior to the enactment of this act, shall abate and be cancelled of record as of the effective date hereof. This act shall be con-

strued as a revision of chapters nineteen through twenty-nine, inclusive, of Title 54 of the Revised Statutes, and nothing herein shall be construed to affect any pending litigation, nor to repeal, abate, cancel, cause to lapse or otherwise affect in any manner any assessment or the lien or obligation to pay any taxes heretofore assessed to any taxpayer, or the legal authority to collect taxes, interest and penalties which have accrued under any provision of law repealed by this act, or under any other law, except as specifically provided in this act. Nor shall this act affect in any manner any distribution, allotment or apportionment of tax receipts made or required to be made under any provision of law repealed by this act.

75. Repealers. Chapters nineteen through twenty-nine, inclusive, of Title 54 of the Revised Statutes are hereby repealed.

Chapter 91, of the laws of 1885;
Chapter 275, of the laws of 1886;
Chapter 333, of the laws of 1921; and
Chapter 423, of the laws of 1933;

are hereby repealed.

Excerpt from Tax Act of 1888 as Amended

54:27-4. *Default; penalty; remedies; lien.*

If the taxes of any company, or any portion thereof, remain unpaid on December first following the levying thereof, the company shall be considered in default, and such taxes, or the unpaid portion thereof, shall thenceforth bear interest at the rate of one per cent for each month until paid, notwithstanding the prosecution of a

writ of certiorari or other remedy. These taxes shall be a lien paramount to all other liens upon all the lands and tangible property and franchises of the company in this state. The lien shall take effect on June first of the year in which the tax is payable and shall be a debt due from the company to the state on that date for which an action at law or suit in equity may be maintained, and shall be a preferred debt in case of insolvency. These remedies are in addition to the special proceedings provided for in chapters 19 to 29 of this title (§54:19-1 et seq., Ch. 208, P. L. 1888 as amended by Ch. 138, P. L. 1921, Sec. 2).

Section 57 of the Bankruptcy Act (11 U. S. C. A. 93)

Sec. 93. *Proof and allowance of claims.*

* * *

(c) Proofs of claim may, for the purpose of allowance, be filed by the claimants in the court of bankruptcy where the proceedings are pending or before the referee if the case has been referred.

(d) Claims which have been duly proved shall be allowed upon receipt by or upon presentation to the court, unless objection to their allowance shall be made by parties in interest or unless their consideration be continued for cause by the court upon its own motion: *Provided, however,* That an unliquidated or contingent claim shall not be allowed unless liquidated or the amount thereof estimated in the manner and within the time directed by the court; and such claim shall not be allowed if the court shall determine that it is not capable of liquidation or of reasonable estimation or that such liquidation or estimation would unduly delay the administration of the estate or any proceedings under this title.

* * *

(f) Objections to claims shall be heard and determined as soon as the convenience of the court and the best interests of the estates and the claimants will permit.

* * *

(h) The value of securities held by secured creditors shall be determined by converting the same into money according to the terms of the agreement pursuant to which such securities were delivered to such creditors, or by such creditors and the trustee by agreement, arbitration, compromise or litigation, as the court may direct, and the amount of such value shall be credited upon such claims, and a dividend shall be paid only on the unpaid balance. Such determination shall be under the supervision and control of the court.

* * *

(j) Debts owing to the United States or any State or subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law.

* * *

(n) Except as otherwise provided in this title, all claims provable under this title, including all claims of the United States and of any State or subdivision thereof, shall be proved and filed in the manner provided in this section. Claims which are not filed within six months after the first date set for the first meeting of creditors shall not be allowed: *Provided, however,* That the court may, upon application before the expiration of such period and for cause shown, grant a reasonable fixed extension of time for the filing of claims by the United States or any State or subdivision thereof: *Provided further,* That,

except in proceedings under chapters 10, 11, 12, and 13 of this title, the right of infants and insane persons without guardians, without notice of the bankruptcy proceedings, may continue six months longer: *And provided further*, That a claim arising in favor of a person by reason of the recovery by the trustee from such person of money or property, or the avoidance by the trustee of a lien held by such person, may be filed within thirty days from the date of such recovery or avoidance, but if the recovery is by way of a proceeding in which a final judgment has been entered against such person, the claim shall not be allowed if the money is not paid or the property is not delivered to the trustee within thirty days from the date of the rendering of such final judgment, or within such further time as the court may allow. When in any case all claims which have been duly allowed have been paid in full, claims not filed within the time hereinabove prescribed may nevertheless be filed within such time as the court may fix or for cause shown extend and, if duly proved, shall be allowed against any surplus remaining in such case. July 1, 1898, c. 541, sec. 57, 30 Stat. 560; Feb. 5, 1903, c. 487, sec. 12, 32 Stat. 799; May 27, 1926, c. 406, sec. 13, 44 Stat. 666; June 22, 1938, c. 575, sec. 1, 52 Stat. 866.

Section 64(a) of the Bankruptcy Act (11 U. S. C. A. 104(a))

Sec. 104. *Debts which have priority.*

a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the

filing fees paid by creditors in involuntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, shall have been recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of such recovery; the costs and expenses of administration, including the trustee's expenses in opposing the bankrupt's discharge, the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases and to the bankrupt in voluntary and involuntary cases, as the court may allow; (2) wages, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; (3) where the confirmation of an arrangement or wage-earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the objection and through the efforts and at the cost and expense of one or more creditors, or, where through the efforts and at the cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under this title, the reasonable costs and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof: *Provided*, That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate

therein as determined by the court: *And provided further,* That, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court; and (5) debts owing to any person, including the United States, who by the laws of the United States is entitled to priority, and rent owing to a landlord who is entitled to priority by applicable State law: *Provided, however,* That such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy.

Section 65(a) of the Bankruptcy Act (11 U. S. C. A. 105(a))

Sec. 105. *Declaration and payments of dividends.*

a. Dividends of an equal per centum shall be declared and paid on all allowed claims, except such as have priority or are secured.

Section 67(b) (c) and (f) of the Bankruptcy Act (11 U. S. C. A. 107(b) (c) and (f))

Sec. 107. *Liens and fraudulent transfers.*

* * *

b. The provisions of section 96 of this title to the contrary notwithstanding, statutory liens in favor of employees, contractors, mechanics, landlords, or other classes of persons, and statutory liens for taxes and debts owing to the United States or any State or subdivision thereof, created or recognized by the laws of the United States or

of any State, may be valid against the trustee, even though arising or perfected while the debtor is insolvent and within four months prior to the filing of the petition in bankruptcy or of the original petition under chapter 10, 11, 12, or 13 of this title, by or against him. Where by such laws such liens are required to be perfected and arise but are not perfected before bankruptcy, they may nevertheless be valid, if perfected within the time permitted by and in accordance with the requirements of such laws, except that if such laws require the liens to be perfected by the seizure of property, they shall instead be perfected by filing notice thereof with the court.

c. Where not enforced by sale before the filing of a petition in bankruptcy or of an original petition under chapter 10, 11, 12, or 13 of this title, though valid under subdivision b of this section, statutory liens, including liens for taxes or debts owing to the United States or to any State or subdivision thereof, on personal property not accompanied by possession of such property, and liens whether statutory or not, of distress for rent shall be postponed in payment to the debts specified in clauses (1) and (2) of subdivision a of section 104 of this title, and, except as against other liens, such liens for wages or for rent shall be restricted in the amount of their payment to the same extent as provided for wages and rent respectively in subdivision a of section 104 of this title.

* * * * *

f. (1) For the purposes of, and exclusively applicable to, this subdivision f (a) "debtor" shall mean a face-amount certificate company as defined in section 80a-4 of Title 15; (b) "face-amount certificate" shall mean a face-amount certificate as defined in section 80a-2 of Title 15; (c) "depositary" is a person or State agency with whom securities or other property of a debtor is deposited or to

whom property of a debtor is transferred, in trust or otherwise, pursuant to the requirements of a State law or an agreement by the debtor providing for the distribution of such property or its proceeds to creditors or security holders of the debtor in the event of the insolvency of the debtor or under other specified circumstances; (d) "deposit creditor" is a creditor who, under the provisions of a State law or agreement providing for a deposit with or transfer to a depositary, has rights as to the securities or property so deposited or transferred which exceed the rights of a general creditor; and (e) "State agency" is an official or agency of a State designated to act as depositary or to distribute property, or the proceeds of property held by a depositary.

(2) Every deposit or transfer of securities or other property made by or on behalf of a debtor with or to any depositary for the benefit or protection of or to secure the holder of any security sold by or on behalf of the debtor on or after January 1, 1941, shall be voidable as against the trustee of such debtor if the property of the estate is insufficient for the full payment and discharge of all claims on account of all face-amount certificates sold by or on behalf of the debtor, and such deposit or transfer and every lien created thereby shall thereupon be avoided by the trustee subject to the provisions of paragraph 3 of this subdivision f.

(3) In the event any deposit or transfer described in paragraph 2 of this subdivision f shall be avoided the trustee shall segregate the property received by the trustee from the depositary and charge the same with the costs and expenses of maintenance and liquidation and distribute the net proceeds thereof to the creditors who would have been entitled thereto under the provisions of the law or

agreement providing for the deposit or transfer of the property, and each such creditor shall thereafter be entitled to dividends from the estate only after all creditors of the same rank shall have received the same percentage.

(4) The court shall have summary jurisdiction of any proceedings to hear and determine the rights of any parties under this subdivision f and to hear and determine the sufficiency of the property of the estate for the full payment and discharge of all claims on account of all face-amount certificates sold by or on behalf of the debtor. Due notice of any hearing in such proceedings shall be given to every depositary and State agency which is a party in interest.

(5) Where the provisions of subsection (c) of section 28 are not applicable, the provisions of this section will not apply. As amended June 2, 1938, c. 575, sec. 1, 52 Stat. 875; Aug. 22, 1940, c. 686, Title 1, sec. 29 (a), 54 Stat. 835.

Pertinent Provisions of Section 77 of the Bankruptcy Act (11 U. S. C. A. 205)

(b) A plan of reorganization within the meaning of this section (1) shall include provisions modifying or altering the rights of creditors generally, or of any class of them, secured or unsecured, either through the issuance of new securities of any character or otherwise; * * * (5) shall provide adequate means for the execution of the plan, which may include the transfer of any interest in or control of all or any part of the property of the debtor to another corporation or corporations, the merger or consolidation of the debtor with another corporation or corporations, the retention of all or any part of the property

by the debtor, the sale of all or any part of the property of the debtor either subject to or free from any lien at not less than a fair upset price, the distribution of all or any assets, or the proceeds derived from the sale thereof, among those having an interest therein, the satisfaction or modification of any liens, indentures, or other similar interests, the curing or waiver of defaults, the extension of maturity dates of outstanding securities, the reduction in principal and/or rate of interest and alteration of other terms of such securities, the amendment of the charter of the debtor, and/or the issuance of securities of either the debtor or any such other corporation or corporations for cash, or in exchange for existing securities, or in satisfaction of claims or rights or for other appropriate purposes; and may deal with all or any part of the property of the debtor; may reject contracts of the debtor which are executory in whole or in part, including unexpired leases; and may include any other appropriate provisions not inconsistent with this section.

The adoption of an executory contract or unexpired lease by the trustee or trustees of a debtor shall not preclude a rejection of such contract or lease in a plan of reorganization approved hereunder, and any claim resulting from such rejection shall not have priority over any other claims against the debtor because such contract or lease had been previously adopted. The term "securities" shall include evidences of indebtedness either secured or unsecured, bonds, stock, certificates of beneficial interest therein, certificates of beneficial interest in property, options, and warrants to receive, or to subscribe for, securities. The term "stockholders" shall include the holders of voting-trust certificates. The term "creditors" shall include, for all purposes of this section all holders of claims of whatever character against the debtor or its property, whether or not such claims would otherwise con-

stitute provable claims under this Act, including the holder of a claim under a contract executory in whole or in part including an unexpired lease.

The term "claims" includes debts, whether liquidated or unliquidated, securities (other than stock and option warrants to subscribe to stock), liens, or other interests of whatever character. For all purposes of this section unsecured claims, which would have been entitled to priority if a receiver in equity of the property of the debtor had been appointed by a Federal court on the day of the approval of the petition, shall be entitled to such priority and the holders of such claims shall be treated as a separate class or classes of creditors. In case an executory contract or unexpired lease of property shall be rejected, or shall not have been adopted by a trustee appointed under this section, or shall have been rejected by a receiver in equity in a proceeding pending prior to the institution of a proceeding under this section, or shall be rejected by any plan, any person injured by such nonadoption or rejection shall for all purposes of this section be deemed to be a creditor of the debtor to the extent of the actual damage or injury determined in accordance with principles obtaining in equity proceedings. The provisions of section 96 of this title shall apply to a proceeding under this section. For all purposes of this section any creditor or stockholder may act in person or by an attorney at law or by a duly authorized agent or committee subject to the provisions of subsection (p) of this section. The running of all statutes of limitation shall be suspended during the pendency of a proceeding under this section.

(c) After approving the petition:

• • •

(7) The judge shall promptly determine and fix a reasonable time within which the claims of creditors may

be filed or evidenced and after which no claim not so filed or evidenced may participate except on order for cause shown, the manner in which such claims may be filed or evidenced and allowed, and for the purposes of the plan and its acceptance, after notice and hearing, the division of creditors and stockholders into classes according to the nature of their respective claims and interests. Such division shall not provide for separate classification unless there be substantial differences in priorities, claims, or interests. The trustee or trustees under any mortgage, deed of trust, or indenture outstanding against the property may, within the time prescribed, file a verified claim in behalf of all bonds or securities outstanding under such mortgage, deed of trust, or indenture, in which event it shall be unnecessary for the holders of such bonds or securities to file claims in their own behalf, but nothing herein shall constitute such trustee or trustees the representative or representatives of such holders for the purpose of accepting or rejecting any plan of reorganization.

• • •

(f) Upon confirmation by the judge, the provisions of the plan and of the order of confirmation shall, subject to the right of judicial review, be binding upon the debtor, all stockholders thereof, including those who have not, as well as those who have, accepted it, and all creditors secured or unsecured, whether or not adversely affected by the plan, and whether or not their claims shall have been filed, and, if filed, whether or not approved, including creditors who have not, as well as those who have, accepted it. Upon confirmation of the plan, the debtor and any other corporation or corporations organized or to be organized for the purpose of carrying out the plan, shall have full power and authority to, and shall put into effect and carry out the plan and the orders of the judge relative

thereto, under and subject to the supervision and control of the judge, the laws of any State or the decision or order of any State authority to the contrary notwithstanding. The property dealt with by the plan, when transferred and conveyed to the debtor or to the other corporation or corporations provided for by the plan, or when retained by the debtor pursuant to the plan, shall be free and clear of all claims of the debtor, its stockholders and creditors, and the debtor shall be discharged from its debts and liabilities, except such as may consistently with the provisions of the plan be reserved in the order confirming the plan or directing such transfer and conveyance or retention, and the judge may require the trustee or trustees appointed hereunder, the debtor, any mortgagee, the trustee of any obligation of the debtor, and all other proper and necessary parties, to make any such transfer or conveyance, and may require the debtor to join in any such transfer or conveyance made by the trustee or trustees. Upon the termination of the proceedings a final decree shall be entered discharging the trustee or trustees, and making such provisions as may be equitable, by way of injunction or otherwise, and closing the case. Upon confirmation of a plan the Commission shall, without further proceedings, grant authority for the issue of any securities, assumption of obligations, transfer of any property, sale, consolidation or merger of the debtor's property, or pooling of traffic, to the extent contemplated by the plan and not inconsistent with the provisions and purposes of chapter 1 of Title 49 as on August 27, 1935, or thereafter amended. The provisions of sections 77a to 77aa of Title 15 shall not apply to the issuance, sale, or exchange of any of the following securities, which securities and transactions therein shall, for the purposes of said sections, be treated as if they were specifically mentioned in sections 77c and 77d of Title 15, respectively: (1) All

securities issued pursuant to any plan of reorganization confirmed by the judge in accordance with the provisions of this section; (2) all securities issued pursuant to such plan for the purpose of raising money for working capital and other purposes of such plan; (3) all securities issued by the debtor or by the trustee or trustees pursuant to subsection (c), clause (3) of this section; (4) all certificates of deposit representing securities of, or claims against, the debtor, with the exception of such certificates of deposit as are issued by committees not subject to subsection (p) of this section. The provisions of subdivision (a) of section 78n of Title 15 shall not be applicable with respect to any action or matter which is within the provisions of subsection (p) of this section.

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IN THE

Supreme Court of the United States

October Term, 1946

No. 92

WALTER P. GARDNER, Trustee of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY,
Petitioner,

vs.

THE STATE OF NEW JERSEY.

BRIEF ON BEHALF OF PETITIONER IN REPLY TO BRIEF ON BEHALF OF THE STATE OF NEW JERSEY and BRIEF ON BEHALF OF THE CITY OF JERSEY CITY, *Amicus Curiae*

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The Attorney General of New Jersey in his brief for the State urges certain concepts that are contrary to settled bankruptcy law. The only concession he makes is that the Bankruptcy Court on the filing of a petition for reorganization by a railroad has authority to enjoin the State from the enforcement of its liens for taxes until the reorganization of the road is effected (State's brief, p. 39). He then urges that the trustee upon his appointment in a reorganization proceeding takes possession only of those

assets of the debtor which are in excess of an amount sufficient to pay the lien of the State in full, with interest at 1% per month (pp. 99, 112).

The Attorney General apparently considers that the State's lien is like a wall that surrounds and encloses a part of the railroad property, the portion within the wall being set apart for the State and that outside the wall being left to the trustee for reorganization purposes. This concept is not supported by the State law (Rev. 54:27-4), nor by any decision in any court of which we have knowledge. Whether this wall encloses the carrier's terminal properties or one or more of its main line tracks is not stated. The adoption of this view of the Attorney General would absolutely prevent the reorganization of a railroad under Section 77.

The next concept urged by the Attorney General is that the Bankruptcy Court is without jurisdiction in any way to question, examine or pass upon the lien given by a State statute (pp. 99-107). He contends that the Bankruptcy Court must either order the amount claimed by the State to be paid in full and in cash, or proceed with the reorganization as to all other parties and claimants and then turn the properties over to the reorganized debtor subject to the State's lien, to the end that the State, being freed of the court's injunction, may enforce its lien against the reorganized debtor in any way that the State statutes permit. This concept would defeat the entire purposes of Section 77 of the Bankruptcy Act, whose protection from such actions by the State was sought by the debtor in this case when it filed its petition for reorganization.

Although the Bankruptcy Act (Sections 57, 64, and 77(c)(7)) provides that a State must file in the proceedings its verified claim and claim a lien if one is asserted, the Attorney General solemnly urges that such a claim, when filed by a duly authorized State officer, is not like the

proof of claim filed by any other creditor, but has no more force or effect than a notice to the trustee and the court and others interested that the State has a lien on the properties of the debtor in the amount stated in the claim (pp. 113 and 115). This, also, is a concept that is new, which has no authority to support it, and, if adopted, would defeat the jurisdiction of the Bankruptcy Court to reorganize a railroad under the provisions of Section 77.

Finally, the learned Attorney General contends that a State which has filed a claim in the proceedings asserting both a lien on all the assets of the debtor and priority over all other creditors in payment, has the right voluntarily to enter the proceedings as a party, and demand and receive large payments on account, out of the general funds of the debtor, without submitting its claim or lien in any respect to the jurisdiction of the Bankruptcy Court, on the ground that the State is a sovereign power which cannot be sued without its consent (pp. 39-40). He glosses over the effect of his many general appearances in the cause and his demand and receipt of very large payments on account of the State's claim, in effect asserting that since "The power to tax is the power to destroy" (*McCullough* v. *Maryland*, 4 Wheat. 316, 427, 429), the Bankruptcy Court must leave the State free to do its will after the reorganization is completed. The adoption of any such concept would utterly prevent the successful reorganization of the debtor.

Conceding *arguendo* that there are important questions for decision raised by the trustees' petition of August 14, 1944, both the State and the City of Jersey City contend that all questions raised thereby should, on the grounds of comity, be referred to the courts of the State for decision, and that the Bankruptcy Court should defer further proceedings before it while awaiting the decision of the State courts on these most important questions.

The answer to this contention is that the decision of the questions raised by the trustees' Petition for Adjudi-

cation of the State tax claim is within the exclusive jurisdiction of the Bankruptcy Court. *Isaacs, Trustee* v. *Hobbs Tie & Timber Co.*, 282 U. S. 734; *Straton* v. *New*, 283 U. S. 318. (See our principal brief, pp. 45 and 52.)

Manifestly, only the Bankruptcy Court has jurisdiction to determine the prime question presented in this case, namely: Whether the claim of the State was compromised under the provisions of Section 27 of the Bankruptcy Act and has been fully paid by the trustee under the instructions and on the orders of the Bankruptcy Court or, if not, in view of equities that have intervened, what further amount, if any, is now due to the State and the terms on which it should be discharged?

I

The State's argument rests on a false premise of fact.

The several contentions of the Attorney General referred to above are based on the erroneous assumption that the amount of the debtor's tax liability for the years 1932 to 1940, inclusive, has been finally adjudicated and that the State has a lien for the full amount of taxes and interest claimed.*

This fallacy also underlies the decisions of the Court of Appeals in *Wilentz* v. *Hendrickson*, 135 N. J. Eq. 244, and of the court below, 152 Fed. (2d) 408.

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*The extent of the State's alleged tax lien is thus defined in the State's brief (p. 83):

> "In the present case, of course, the tax debt to the State of New Jersey, both for principal and interest, is secured by a statutory lien on all of the lands, tangible property and franchises of the debtor situated in this State. R.S. 54:27-4; R.S. 54:27-6; Wilentz v. Hendrickson, *supra*, where it was stated (133 N. J. Eq., at p. 466):
>
> "'The reference to the obligation for which a lien is given embraces the accrued interest.'"

As we have shown in the Statement of Facts in our principal brief (pp. 5-8, incl.), only the litigation in the State and Federal Courts concerning taxes for the years 1932 and 1933 had been concluded prior to the filing of debtor's petition for reorganization.

The State's taxes for 1934, 1935 and 1936 were under contest when the petition for reorganization was filed, and the judgment of the United States District Court reducing the amount of taxes for said years was not reversed by the Circuit Court of Appeals until November 27, 1940 (see State's Proof of Claim, R. 70, 71).

The State's claim for taxes for the years 1937, 1938 and 1939 were duly appealed to the State Board of Tax Appeals and such appeals had not been determined by that body at the time of the filing of the State's proof of claim on or about December 10, 1940 (R. 71). In accepting the provisions of the Settlement Acts the trustees waived their right to a judicial review of such taxes after they were affirmed by the State Board. As to the taxes for 1940 and 1941, even an administrative review was waived. Moreover, there has been no judicial review of the State's enormous claim for interest. The State's claim represents merely the debtor's maximum liability.

The one and only thing that settled and fixed the principal amount of the taxes and interest payable to the State was the undertaking filed with the State Treasurer by the trustees under Chapter 290, P. L. 1941, as amended by Chapter 241, P. L. 1942, in which undertaking, with court approval contained in Orders Nos. 123, 135 and 163, the trustees agreed to pay the principal amount of delinquent taxes levied for the years 1932 through 1940, in annual instalments over a period of twenty years, together with interest at 3% per annum from December 1, 1940.

II

The State's argument also rests on a false premise of law, that is, that the estate *in custodia legis* is only the equity above the liens.

The contentions of the Attorney General wholly disregard what this Court said in *Straton* v. *New*, 283 U. S. 318, p. 321, regarding the jurisdiction of the Bankruptcy Court:

> "This jurisdiction is exclusive within the field defined by the law, and is so far in rem that the estate is regarded as *in custodia legis* from the filing of the petition."

The proceeding is in rem as to every piece of property, owned and possessed by the debtor as of the date of the filing of the petition. *Isaacs, Trustee* v. *Hobbs Tie & Timber Co., supra.* In view of the law as settled by this court on the authorities stated in our principal brief, the contention of the State that its lien can in no respect be questioned, examined or determined in nature, amount or extent, is wholly without merit.

The Attorney General, however, contends that the only property in the hands of the trustee is the equity beyond the State's lien. He does not indicate how the amount of that equity can be determined other than by the Bankruptcy Court. If he is correct in his contention that the Bankruptcy Court lacks power to pass upon the amount and validity of the State's lien, then it necessarily follows that the court can never evaluate the equity which he asserts is the only asset the trustee is possessed of and of which the court has jurisdiction.

At this point we think the court's attention should be called to Section 77(e) of the Bankruptcy Act, which provides that the valuation "of any property for any purpose under this section shall be made by the Interstate Commerce Commission" with due regard to the earning power of the property.

III

The question of what interest, in view of all the equities, should be allowed on the State's claim may be of paramount importance in this proceeding.

We have shown that if it be determined that a compromise was effected between the State and the debtor's trustee under the terms of the Railroad Tax Settlement Acts, the State is entitled only to the principal of the taxes for 1932 to 1940, inclusive, together with 3% interest thereon from December 1, 1940. In the event, however, that it should be determined that there was no such compromise, then a highly important question will arise as to whether any interest should be allowed the State on its tax claims from and after the date of the filing of the petition for reorganization in view of the decision of this Court in *Vanston Bondholders Protective Committee* v. *Green, et al.*, filed December 9, 1946 (Nos. 42-45, Oct. Term, 1946).* The opinion of Mr. Justice Black contains these statements:

> "A purpose of bankruptcy is so to administer an estate as to bring about a ratable distribution of assets among the bankrupt's creditors."

Again:

> "But bankruptcy Courts must administer and enforce the Bankruptcy Act as interpreted by this Court in accordance with authority granted by Congress to determine how and what claims shall be allowed under equitable principles. And we think an allowance of interest on interest under the circumstances shown

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* Another highly important question arises as to the applicability of the following equitable principle: A court of equity has jurisdiction to enforce a compromise from which the offeror seeks to withdraw where the offeree has acted thereon to his prejudice.

Trenton Street Railway Co. v. *Lawlor* (E. and Ap.), 74 N. J. Eq. 828.

by this case would not be in accord with the equitable principles governing bankruptcy distributions.

When and under what circumstances Federal Courts will allow interest on claims against debtors' estates being administered by them has long been decided by federal law (citing cases)."

We have shown in our main brief how the State has thwarted an adjudication as to the amount of its claim by the litigation and appeals which its Attorneys General have prosecuted.

The State contends that the penalty interest continues to run at 1% per month until both the principal and interest are paid in full under the formula laid down by Justice Oliphant in *State* v. *Erie Railroad Co., et al.*, 23 N. J. Misc. 203.* These interest penalties are so large as far to exceed the principal amount of the taxes, to the great detriment of the bondholders who are secured by a mortgage on the debtor's entire assets. Suppose these interest penalties had been 2% or 3% per month instead of 1% per month, and suppose the State Courts had determined that they were not penalties but interest? Would the Bankruptcy Court be obliged to hold them to be interest rather than penalties, even though they would consume the entire estate of the railroad? It is not to be overlooked that when the petition for reorganization was filed the total liquid resources of the railroad were $7,097,458 against the principal of taxes claimed by the State aggregating $15,067,002 (R. 199, 200) exclusive of interest penalties.

It is respectfully submitted that under the decision in the *Vanston* case, *supra*, the Bankruptcy Court alone has the jurisdiction, acting on equitable principles and paying due regard to the interests of all persons interested in the debtor's estate, to determine whether it would be equitable to allow the State to recover its penalties in full.

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* Legal interest in New Jersey is 6% per annum. R. S. 31:1-1.

IV

The Trustees' petition of August 14, 1944, for adjudication concerning the State tax claims was not a suit against the State because (A) this is a proceeding *in rem* in which the State has appeared as claimant; and (B) the only determination requested is an adjudication as to the amount, if any, payable to the State on its claim and the nature and extent of its lien.

(A) The State appeared as a claimant.

It is well settled that when the State's claim was formally filed in the Bankruptcy Court its alleged lien became merely incidental thereto. *Coder* v. *Arts*, 213 U. S. 223; *In re Florence Com. Co.*, 19 Fed. (2d) 468.

The contention of the Attorney General that the proof of claim filed by the State was a mere notice is answered by the decision of this court in *New York* v. *Irving Trust Co.*, 288 U. S. 329, p. 333, where it was said:

> "If a State desires to participate in the assets of a bankrupt, she must submit to appropriate requirements by the controlling power; otherwise, orderly and expeditious proceedings would be impossible and a fundamental purpose of the Bankruptcy Act would be frustrated."

When the State appeared in the debtor's proceedings both before and after filing its proof of claim and demanded payments on account, it made an election, if ever a State can make an election, to appear voluntarily and seek liquidation of its claim. When it filed its claim in the proceedings it, of course, submitted that claim to the jurisdiction of the Bankruptcy Court. In addition, when the State passed its Settlement Acts, Chapter 290, P. L. 1941, and Chapter 241, P. L. 1942, it in terms authorized

and directed the Attorney General "to execute in the name of the State of New Jersey any and all consents to a plan or plans of reorganization of a railroad corporation under the Federal Bankruptcy or other laws, to the extent that such plan provides for payment to the State on claims for taxes in accordance with the provisions of the Act" (Sec. 9).

(B) The only affirmative action sought is an adjudication of the amount, if any, still payable to the State on its claim and the extent of its lien.

No right is asserted by the trustee against the State which extends beyond the claim that the State has filed. The trustee merely wants the Bankruptcy Court to determine, as it must determine before there can be a reorganization of the debtor: (1) How much is due the State, if anything, for principal of its taxes; (2) How much is due the State for interest on its claims, if anything; (3) What lien, if any, does the State now have; and (4) As between the bondholders and the State, who has priority?

The petition for a decision on these questions is simply in the nature of a motion in a pending proceeding and does not constitute a suit against the State without its consent.

Cohen v. *Virginia*, 6 Wheat. 264;
Wiswall v. *Campbell*, 93 U. S. 347;
Hanover National Bank v. *Moyses*, 186 U. S. 181;
Meek v. *Centre County Banking Co.*, 268 U. S. 426;
In re Williams Oil Corp., 265 Fed. 401;
U. S. v. *Moscow Seed Co.*, 14 Fed. Supp. 135.

Finally, the Attorney General, overlooking the decision to the contrary in *Hanover National Bank* v. *Moyses* (*supra*), seems to think that the only way a State can be

made a party to such a reorganization proceeding is by the issuance of process of some kind against the State.

It is elemental that a State, like any other person, firm or corporation, may enter a judicial proceeding by voluntarily appearing and petitioning for some right or benefit in its own favor, e. g., by asking for immediate cash payments on a claim that might otherwise be deferred, and by filing a claim for relief.

V

Such questions as remain open are exclusively for the Bankruptcy Court.

The assertion by both Jersey City and the State that questions concerning the State's claim and lien should be referred to the State courts on the grounds of comity and on the authority of *Spector Motor Service, Inc.* v. *McLaughlin*, 323 U. S. 101, is one that invites further delay in reorganization proceedings that should long ago have been concluded, and invites the Bankruptcy Court to yield its exclusive jurisdiction to the State in matters that the Bankruptcy Court alone is competent to deal with promptly and efficiently. Unlike the situation in the *Spector* case, the New Jersey law has already been settled. Under the New Jersey law, as we have shown in our principal brief, there was a valid compromise. See also *Trenton Street Railway Co.* v. *Lawlor* (E. & Ap.), 74 N. J. Eq. 828.

Moreover, the settlement was valid under Section 27 of the Bankruptcy Act, as we have heretofore shown, and that question is not even discussed in the State's brief. The State does, however, contend on the authority of *Hyman* v. *Long Branch Kennel Club*, 115 N. J. L. 123, that in New Jersey "An act which violates the Constitution with respect to subject matter is void ab initio" (Brief, p. 127).

While the *Long Branch* case disapproved a dictum in *Lang* v. *Bayonne*, 74 N. J. L. 455, it did not in any sense purport to set aside the New Jersey rule on which we rely in our principal brief (pp. 75-77), i. e., that the holding that a statute is unconstitutional does not mean that it may be treated as a nullity if action was taken under it prior to a decision that it is unconstitutional, or the other New Jersey doctrine on which we rely, that a decision that an Act of the Legislature is unconstitutional, based upon a stipulation as to the facts, operates only in personam on the parties to the action who made the stipulation, and not in rem.

We have heretofore referred to the fact that the obstructive tactics of the Attorney General's office have prevented the speedy reorganization of the debtor which Section 77 contemplates. We find in the State's brief (p. 51) this statement:

> "Just how much power did Congress intend to give the Bankruptcy Court with respect to a State's liens for taxes affixed at the time of the institution of Section 77 proceedings?
>
> "Unless this vital question can be answered at this time, the State of New Jersey already considerably harassed with seemingly endless litigation with respect to these taxes, may be compelled twice more to come before this Court—first, in opposition to a claimed power to include the New Jersey taxes in a reorganization scheme otherwise than on the basis of cash payment; and, secondly, in opposition to a claimed power in the Bankruptcy Court to compel the State to participate in a plan providing for other than cash payment upon the State's refusing to participate voluntarily in such plan."

A somewhat similar suggestion of interminable further litigation appears in Jersey City's brief, pages 43, 44.

Accompanying this threat of further litigation is the insistment of the State, on page 128, that in view of the decision in the *Spector* case (*supra*) the Bankruptcy Court should refer the questions presented in the trustees' petition of August 14, 1944 to the State courts,—a proceeding which would still further unnecessarily prolong the debtor's reorganization, because, as this Court pointed out in *Public Utilities Comm.* v. *United Fuel & Gas Co.*, 317 U. S. 456, p. 463:

> "But where, as here, no state court ruling on local law could settle the federal questions that necessarily remain, and where, as here, the litigation has already been in the federal courts an inordinately long time, considerations of equity require that the litigation be brought to an end as quickly as possible."

It is respectfully submitted that on the record now before the court, this Court may, if it deem proper, issue such instructions to the courts below as will be dispositive of the very important questions that are presented in this case.

For the State seriously to urge that the State Treasurer is enjoined by the decree in *Wilentz* v. *Hendrickson* from accepting payment of the amount of its claims in accordance with the terms of the Tax Settlement Acts seems idle, because if the compromise is valid at law or available as an equitable defense (see *Trenton St. Ry. Co.* v. *Lawlor*, 74 N. J. Eq. 828), the State already has received full payment (see Order No. 333, R. 296; receipt for $15,250,000, R. 318).

If it should, on the other hand, be determined that there was no compromise, and that no equities in favor of debtor have intervened, so that the State is entitled to collect the full amount of its taxes assessed plus penalties of

1% per *month* from the date in each year when the taxes were payable to the date of payment in full, an amount aggregating some additional $15,000,000, then, of course, the reorganization court and the Interstate Commerce Commission will have to provide in a plan how such claim can be liquidated.

December 16, 1946.

Respectfully submitted,

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Supreme Court of the United States

OCTOBER TERM, 1945

No. 1143

WALTER P. GARDNER, Trustee of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY,

A Debtor-Petitioner,

vs.

THE STATE OF NEW JERSEY,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

STATEMENT.

On August 14, 1944, the Trustees of the Debtor, in reorganization under Section 77 of the Bankruptcy Act, filed a petition entitled "Petition for Adjudication Concerning New Jersey State Tax Claims and for Order No. 250," which we shall hereinafter refer to as the petition of August 14 (T. pg. 55a). That petition prayed (T. pg. 79a):

> "that this Honorable Court, the premises considered, may promptly adjudicate (1) whether petitioners entered into a contract with the State of New Jersey, (2) whether such contract is binding on the parties

thereto, (3) whether, if not binding on the State, petitioners are nonetheless bound by the prejudicial actions taken by them, (4) if not binding on the parties thereto including petitioners, to what extent, if at all, the proofs of claim of the State of New Jersey should be allowed, (5) what order should in such event be made to restore the equivalent of the status quo ante as nearly as may be and (6) what in such event are the relative rights, claims, liens and priorities of the claimants in the assets of the Debtor's Estate; and that this Honorable Court may instruct petitioners whether to make on or before December 1, 1944 the additional payment on account of the taxes claimed and the additional interest payment required by Chapter 290 of the Laws of 1941, as amended by Chapter 241 of the Laws of 1942."

Conceiving that the Bankruptcy Court was wholly without jurisdiction to entertain such petition for the reason that (1) there is no power in the Bankruptcy Court summarily to review the matters and make the determinations or adjudications requested, and that, even if there were such power (2) the making of such determinations and adjudications concerning liens of the State affixed at the time of bankruptcy constitutes a suit against the State which may not be maintained without the State's consent, the State of New Jersey appeared specially and moved to dismiss the said petition on August 14.

The Bankruptcy Court's finding that the requisite jurisdiction did exist was reversed by the Circuit Court of Appeals as reported in *In re Central Railroad of New Jersey*, 152 F. (2d) 408. To understand the questions presently before this Court and in order to determine the applicability of the several sections of the Bankruptcy Act to the matters presently in controversy, a detailed statement of the prior litigation, which quite obviously impressed the Court below, is deemed necessary.

a. *Concerning the litigation with respect to the assessment of the* 1932 *to* 1939 *taxes.*

The current controversy concerning the assessment methods employed by the taxing authorities in the State of New Jersey actually began with the review of the 1931 assessments. The New Jersey Supreme Court denied a request for a reduction in the 1931 assessments in *Central Railroad Company of New Jersey* vs. *State Board of Tax Appeals*, 109 N. J. L. 395. The New Jersey Court of Errors and Appeals affirmed this judgment (112 N. J. L. 5) and certiorari was denied by this Court (293 U. S. 568). The 1931 taxes have been paid.

The Debtor appealed its 1932 assessment to the State Board of Tax Appeals. The assessment was affirmed after hearing. No application was made to the Supreme Court for a review of this judgment. The Debtor appealed its 1933 assessment to the State Board of Tax Appeals. This assessment was affirmed after hearing. The Debtor was then granted a review of the 1933 assessment by the New Jersey Supreme Court. On December 11, 1934, the Supreme Court affirmed the judgment of the State Board in *Central Railroad Company* vs. *Martin*, 114 N. J. L. 69. No appeal was taken to the New Jersey Court of Errors and Appeals, but instead this Debtor and certain other railroad companies brought suit in the United States District Court for the District of New Jersey, seeking a permanent injunction against the collection by the State of New Jersey of a portion of the taxes assessed against them for the years 1932 and 1933. The dismissal by the District Court of their application was affirmed by the Circuit Court of Appeals in *Lehigh Valley Railroad Company* vs. *Martin*, 100 F. (2d) 139, decided November 15, 1938. Application for certiorari was denied by this Court on April 19, 1939 (306 U. S. 651, rehearing denied 306 U. S. 669).

When the Attorney-General of New Jersey started proceedings to enforce the State's lien for taxes, the Debtor filed its petition under Section 77 of the Bankruptcy Act (T. pg. 57a).

Notwithstanding that all questions concerning the amount of the 1932 and 1933 taxes had been determined adversely to the Debtor and notwithstanding that the bankruptcy act gave power to the Trustees to borrow on trustees' certificates, in a market which this Court will judiciously notice could have been effected at a very low rate, the Trustees continued to resist the collection of the said taxes and allowed further interest to accumulate at 1% per month from October 30, 1939, down to and including the date that the present petition for certiorari was filed. (The Trustee since the filing of present petition for certiorari has made a substantial part payment on the tax debt, reserving all rights to continue litigation.)

Notwithstanding what had been said by the New Jersey Courts in the 1931 and 1933 cases, and again by the Court below with reference to the combined 1932 and 1933 cases, nevertheless this Debtor and other railroad companies appealed their 1934, 1935 and 1936 assessments to the State Board of Tax Appeals. No reviews of the judgments of the State Board for the years 1934, 1935 and 1936 were sought from the New Jersey Supreme Court in the manner provided by statute. On the contrary, the Debtor and the other railroad companies again resorted to the Federal Courts. The United States District Court entered a decree enjoining the collection of more than 60% of the 1934, 1935 and 1936 assessments until a revaluation of the property should be made by the State taxing authorities in conformity with the opinion of the said District Court. This was later increased to 70%. Upon appeal by the State, the judgment was reversed in *Central Railroad Company* vs. *Martin*, 115 F. (2d) 968, decided November 27, 1940. By their petition of August 14, the Trustees deny

that they were a party to the appeal before the United States Circuit Court of Appeals. Reference to the record in that case will show, however, that the Debtor did appear in the proceedings and that the injunction running against the State and to the said Debtor was dismissed. The mandate of the Circuit Court to the District Court specifically set aside the decree in favor of this Debtor. It is worthy of observation that counsel in the Circuit Court of Appeals' case was one of those whose name apears upon the present petition before this Court.

The present Debtor did not apply for certiorari to review this judgment. The New York, Susquehanna and Western Railroad Company, a party to the proceedings before the Circuit Court of Appeals and which is also under Section 77 bankruptcy proceedings, likewise did not seek certiorari. Judge Clark, who sat in the New York, Susquehanna and Western case, said with reference to further proceedings concerning such taxes, as reported in 38 Supp. 158, 160:

"We insist upon a proscription of futility."

All of the other railroad companies with the exception of the two just mentioned sought certiorari from this Court which was denied on April 28, 1941 (313 U. S. 568).

The Court below in reversing the judgment in the said case held that the question of the assessment method employed in connection with the 1934, 1935, and 1936 taxes had been made res adjudicata by *Central Railroad* vs. *Martin*, 114 N. J. L. 69, *supra*. We wish to emphasize that the United States Circuit Court of Appeals did not determine that legal questions concerning the assessing method used in arriving at the 1934, 1935 and 1936 taxes had been made res adjudicata by anything done below in those years, but on the contrary, held that all Federal questions had been made res adjudicata by the judgment of the New Jersey Supreme Court in connection with the 1933 assessments.

And again we call attention to the fact that notwithstanding what was said in that case, a large amount of 1934, 1935 and 1936 taxes were still due to the State of New Jersey at the time of the filing of the present petition for certiorari.

The Debtor and other railroad companies appealed their 1937 and 1938 assessments, which were at exactly the same level as the 1936 assessments, to the State Board of Tax Appeals. The two years were heard as a unit and an aggregate of 4,610 pages of testimony were taken and 450 exhibits were introduced into evidence. The assessments were affirmed by the State Board on May 13, 1941. Since the identical assessing method was employed, *Central Railroad* vs. *Martin*, 115 F. (2d) 968, *supra*, must be controlling and it must be the law of these latter years that all questions concerning the assessment method for such years had likewise been made res adjudicata by *Central Railroad* vs. *Martin*, 114 N. J. L. 69, *supra*. It was not the passage of the "Settlement Acts" which caused the railroads to refrain from again resorting to the certiorari procedure provided by our statutes or to the Federal Courts in the manner set forth above. They had exhausted every remedy that promised even a possibility of success and were confronted with the situation which caused the learned Judge in the *Susquehanna* case to make the classic remark concerning a "proscription of futility."

The Debtor appealed its 1939 assessment to the State Board of Tax Appeals. In that year the State Tax Commissioner made primary valuations substantially the same as those in 1938. On a review of the primary assessment provided by statute, the State Tax Commissioner made adjustments downward on water-front property. Appeals were taken from the final determination of the State Tax Commissioner by the Debtor seeking a further reduction and by the City of Jersey City seeking to have the assessments increased. The State Board of Tax Appeals dismissed the Debtor's appeal and restored the assessments

to the level of the 1938 assessments. The Trustees were notified of these decisions by letter dated June 15, 1942. Thereupon the Trustees obtained from the District Court an order upon the State taxing authorities and the Attorney-General to show cause why the judgment of the State Board of Tax Appeals should not be declared null and void. After hearing the District Court entered Order No. 171, whereby it was determined that the Debtor's tax liability for 1939 had been definitely fixed by Order No. 163, which had in turn fixed the assessment for 1939 at the lower level. This order was reversed by the United States Circuit Court of Appeals in *In re Central Railroad Company of New Jersey*, 136 F. (2d) 633, 640. An application for a writ of certiorari from this Court was denied (320 U. S. 805).

The above covers all of the tax years prior to bankruptcy. Notwithstanding the litigation set out above, all of which had been determined adversely to the Debtor, we find the amazing statement on page 8 of the petition for certiorari in this case that:

> "The taxes for the years 1934-1940, inclusive, were all in litigation before various administrative tribunals and courts."

The brief had reference to the time of the adoption of the first "Settlement Act" on July 22, 1941. It is this thorough lack of appreciation of the effect of the above-mentioned judgments that has given rise to these present proceedings whereby the Trustees of the Debtor again seek to litigate matters long since declared by courts of competent jurisdiction to have been res adjudicata.

b. *Concerning the Tax Settlement Acts litigation.*

As we have stated, notwithstanding the successful termination of the litigation for the tax years 1932 to 1936, all adversely to the claims of the railroad companies, large amounts of taxes for those years still remained unpaid in July, 1941. The Legislature of the State of New Jersey, in a spirit of desperation brought about by the concerted refusal of the railroad companies to pay millions of dollars in taxes due and payable to the State of New Jersey, adopted Chapter 290 of the Laws of 1941, whereby it was sought to forgive the several railroad companies their obligation to pay back interest and to permit the payment of the principal amount of the taxes over a period of years plus 3% interest on the unpaid balance. This Act and Chapter 241 of the Laws of 1942, which is amendatory thereof, are designated as the "Tax Settlement Acts."

The 1941 Act provided in Sections 7 and 8, as set forth on page 7 of the Petition for Certiorari, for the participation by the Attorney-General in the tax settlement scheme. The Attorney-General being of the mind that the Act was unconstitutional refused to give his consent and instead on September 4, 1941, (barely six weeks after the passage of the Act), filed an information in the Court of Chancery of New Jersey seeking a determination as to the constitutionality of the said Settlement Act.

The railroad companies seeking to obtain the benefits afforded by the said Act, regardless of the refusal of the Attorney-General to participate in the settlement machinery, discontinued certain pending further appeals of their 1937 and 1938 taxes. From the above it can be seen that such discontinuance was a matter of form only as there was no meritorious questions left to be litigated. As was said in *Wilentz* vs. *Hendrickson*, 135 N. J. Eq. 244, 260, with respect to this very litigation:

> "• • • the asserted rights of the railroad taxpayers are 'illusory,' rather than real."

Be that as it may a reading of the Act discloses that there was no necessity of discontinuing these suits. It was only required that discontinuance documents be filed with the fiscal officers of the State which would have been returned just the same as the purported tenders of the railroads had to be returned upon the determination that the Acts were unconstitutional.

Notwithstanding that the several railroad companies did not seek to intervene in the tax settlement controversy and were not parties to such litigation, the record discloses that the matter was strongly litigated, the Attorney-General on the one hand urging the unconstitutionality of the Acts and the State Treasurer on the other, through eminent counsel, urging the constitutionality of such Acts. Not only this but the Legislature of New Jersey sought to cure obvious constitutional deficiencies by the adoption of the amendatory act in May, 1942 (Chapter 241 of the Laws of 1942) during the pendency of such litigation.

On May 21, the very day the amendatory act was enacted into law, under which the participation of the Attorney-General was eliminated, an injunction issued out of the New Jersey Court of Chancery restraining the State fiscal officers from accepting any payment or otherwise performing the terms of the Settlement Acts. On July 20, 1943, the Court of Chancery determined the Settlement Acts to be unconstitutional (*Wilentz* vs. *Hendrickson*, 133 N. J. Eq. 447). The New Jersey Court of Errors and Appeals affirmed the decree of the Chancery Court on June 22, 1944. (135 N. J. Eq. 244.)

In the meantime and on June 2, 1942, the Trustees petitioned the District Court for instructions with reference to their compliance with the Settlement Acts. As a result of such petition, the Trustees were instructed and directed to comply with the said Settlement Acts and Order No. 163 was entered fixing the amount due to the State of New Jersey for taxes and interest at the amount that was provided

by the terms of the said Acts. The State of New Jersey appealed to the United States Circuit Court of Appeals for the Third Circuit. On May 27, 1943, the said Court reversed the said Order No. 163 and held that the District Court in the exercise of a nice discretion should have withheld any determination as to the constitutionality of the Settlement Acts pending the determination by the New Jersey Courts of such questions (136 F. 2nd 633). It is significant that the Circuit Court of Appeals made its determination prior to the judgment by the New Jersey Court of Chancery and in plenty of time for the Trustees to have applied to intervene in the New Jersey Settlement Acts litigation. A re-hearing was denied on July 15, 1943, still prior to July 20, 1943, the date of the judgment by the Chancery Court. It should likewise be pointed out that the Trustees had more than one year from May 27, 1943, until June 22, 1944, when the Court of Errors and Appeals made its final determination within which to intervene in the Settlement Acts' controversy.

The Trustees by their petition of August 14, now seek to have the Bankruptcy Court make an adjudication that a binding contract exists with the State of New Jersey upon the basis of their abortive attempts to comply with the terms of the unconstitutional Settlement Acts. This contention was disposed of adversely to the Trustees in *In re Central Railroad Company of New Jersey*, 136 F. (2d) 633, 638, *supra*, wherein the Court said:

> "The final contention that the issue between the State and the Trustees is moot by reason of the tender to the Treasurer of a payment pursuant to Order No. 163 must also fail. The tender though acknowledged was not accepted by the Treasurer and consequently was without legal effect. In fact, the Treasurer was powerless to accept the tender by reason of the injunction issued by the Court of Chancery.",

The very same argument that is now advanced by the Trustees in connection with the present application was advanced before this Court in connection with an application for a writ of certiorari to review the judgment in the just mentioned case, which application was denied. (320 U. S. 805.)

c. *Concerning the litigation on the August 14 petition.*

As stated above, approximately two months after the New Jersey Court of Errors and Appeals made its determination in *Wilentz* vs. *Hendrickson, supra,* the Trustees filed its petition of August 14, wherein the Trustees sought to have the Bankruptcy Court make certain determinations with respect to the taxes and interest due to the State of New Jersey, as more particularly set forth on page 1 above.

The Trustees have set forth on page 2 of their petition "the essential questions" which must be determined. It is apparent from a reading of the petition of August 14, and the present petition that the Trustees still seek to have the Bankruptcy Court make a re-determination of the questions decided adversely to themselves in *Wilentz* vs. *Hendrickson, supra,* and in *In re Central Railroad Company of New Jersey, supra.* It is also quite apparent that the Trustees sought by the petition of August 14, to have the Bankruptcy Court re-determine certain tax questions which had been said by the Federal Courts to have been made res adjudicata by the New Jersey Supreme Court in *Central Railroad Company* vs. *Martin,* 114 N. J. L. 69, *supra.* They have requested the Bankruptcy Court to make certain other adjudications but have not shown where the Bankruptcy Act has given jurisdiction to the Court in such matters.

Since all of the taxes due to the State of New Jersey had become a lien paramount to all other liens upon the lands, tangible property and franchises in the State of New Jersey, not later than June 1, 1939, and over four months prior

to October 30, 1939, when the petition in bankruptcy was filed, the State moved on special appearance to have itself dismissed as a party to the said petition insofar as it was sought to take jurisdiction for the purpose of making adjudications that would be binding upon the State of New Jersey with respect to the tax liens of the said State. The argument of the State concerning the jurisdiction of the Bankruptcy Court was comprised within two broad classifications (1) Congress did not give power to the Bankruptcy Court to undertake the review sought by the Trustees in the instant case; and (2) if Congress intended to grant such power in a case such as this, such grant of power is unconstitutional in that it violates the right of the State to be immune from suit in any court of the United States unless the State consents thereto.

Over objection of the State, the District Court Judge referred the matter contained in the petition of August 14, including the jurisdictional questions to the Standing Master for determination and report. The Standing Master made a finding that the Bankruptcy Court did have jurisdiction to entertain the several matters contained in the said petition. Again, over objection of the State, the District Court Judge confirmed the report of the Standing Master by its Order No. 271.

The Court below, in reversing this order, held that it was not necessary to answer the jurisdictional objections set forth in the two broad classifications above because the jurisdiction of the Bankruptcy Court was limited in the manner set forth in *Arkansas Corporation Commission* vs. *Thompson*, 313 U. S. 132. It held, in effect, that even if there is jurisdiction, yet under the facts of the instant case such jurisdiction is limited to a determination of whether there was mathematical error in computation. The Court said that:

"Failure of this opinion to touch upon certain points raised by the State of New Jersey is not to be construed as meaning that they are without merit; rather, our decision renders discussion of them unnecessary."

The Court thereupon reversed Order No. 271 with costs to the State and stated that since this disposed of the entire matter before them the application for the writ of prohibition should be dismissed without costs to either party.

d. *Concerning the present petition of the Trustee.*

Several matters contained in the petition and brief of the Trustee require denial or clarification in this statement rather than in the argument:

1. The Trustee's statement (Pet. pg. 10) that the Trustees had fully complied with the terms of the Railroad Tax Settlement Acts is contrary to the law of this case as determined in *In re Central Railroad Company of New Jersey*, 136 F. (2d) 633, 638 (5).

2. The Trustees' insistence that the 1934-1940, inclusive, taxes (Pet. pg. 8) were still in litigation on July 22, 1941, is without any support in fact. *Central Railroad* vs. *Martin*, 115 F. (2d) 968, *supra*, is completely dispositive of this contention.

3. The Trustees' contention that they were required to discontinue the alleged appeals is without foundation in fact. They were simply required to comply with the terms of the Settlement Acts as set forth on page 7 of the Trustees' petition, a reference to which will show that a tender of the required documents would have been a compliance in the same manner as their attempted compliance by tendering the several payments required by the terms of the Act. Had the Acts been declared to be constitutional, this would have been compliance with said terms. The Courts upon application would have permitted a continuance of pending litigation during the time needed to determine the constitutional question.

4. The Trustees' assertion that the denial of the State's petition for a writ of prohibition is not before this Court is without merit. The Court below on its own motion consolidated the argument on the two cases in order that the jurisdictional questions would be before the Court. A disagreement with the Court below concerning the limits of the Court's jurisdiction under the *Arkansas Corporation Commission* case could result in this Court's arriving at the same result but for different reasons on the basis of the full record in the Court below.

5. The State by its claim filed in this cause gave notice to the Bankruptcy Court that it had a lien for its 1932 to 1939 taxes under the appropriate New Jersey statutory provisions and laid the basis for a claim against the unsecured assets of the Debtor in the event that the security afforded by the statute should be insufficient to pay the amount of tax and interest due to the said State.

6. The Trustees (Pet. pg. 17) cites the case of *Hyman* vs. *Long Branch Kennel Club*, 115 N. J. L. 123, in support of the premise that the Trustee could obtain rights under the Settlement Acts prior to the determination by the Courts of the State of New Jersey that such acts were unconstitutional: The *Hyman* case is authority for just the contrary doctrine. The said case is authority for the rule that an unconstitutional statute is void from the beginning.

7. On page 10 of the petition, the Trustees state that they do not now contend they are entitled to a reduction in the principal amount of the taxes as assessed. A reading of that paragraph discloses that the Trustees do not come to such conclusion because of the great amount of litigation which has resulted adversely to themselves in connection with such taxes, but they rely upon the premise that the amount has been settled by reason of their compliance with the Tax Settlement Acts, a question already determined adversely to themselves in *In re Central Railroad Company of New Jersey*, 136 F. (2d) 633, *supra*, wherein Orders No. 163 and No. 171 were reversed.

SUMMARY OF ARGUMENT.

The Trustees have petitioned this Court for a writ of certiorari to review a judgment of the Third Circuit reversing an order of the Bankruptcy Court whereby the said Bankruptcy Court determined that it had jurisdiction to make certain adjudications requested by the Trustees in the petition of August 14. The Trustees have failed to show in what respect the said order of reversal has done violence to any authoritative pronouncement of this Court. This lack is quite understandable since, with respect to two of the only three important questions presented by the said petition, this Court has spoken with definiteness and finality in *Arkansas Corporation Commission* vs. *Thompson*, 313 U. S. 132, and *Meilink* vs. *Unemployment Reserves Commission*, 314 U. S. 564. The third question was before the Third Circuit in *Central Railroad Company of New Jersey*, 136 Fed. (2d) 633, wherein the said Court reversed Order No. 163 of the Bankruptcy Court in these proceedings, which Order sought to do exactly what the Trustees hope to accomplish by the petition of August 14. (Cert. den. 320 U. S. 805.)

The Trustees in the Court below urged that Section 64 gave power to the Bankruptcy Court to make the requested adjudications. In our first point we show the limits of the power contained in Section 64 as determined by this Court in the said *Arkansas Corporation Commission* case. We will argue that, on the facts of this case, the power of the Bankruptcy Court was so limited that it was, in fact, wholly without power to consider one single prayer.

While we believe with the Court below that this determination by this Court is dispositive of the whole matter, nevertheless we have considered at length the other two questions. In Point II we deal with the former attempt of the Trustees to have the Bankruptcy Court fix the liability

of the Trustees at the amount prescribed by the Settlement Acts. The Court there had before it the very same argument concerning the existence of a contract and disposed of this contention adversely to the Trustees. As we show in our Point II the determination by the New Jersey Court of Errors and Appeals in *Wilentz* vs. *Hendrickson*, 135 N. J. Eq. 244, is dispositive of the other questions urged by the Trustees in this connection.

In Point III we deal with the power of the Bankruptcy Court to denominate as a penalty that which by State statute is stated to be interest. This case is clearly within the rule laid down by this Court in *Meilink* vs. *Unemployment Reserves Commission, supra,* wherein it was held in construing almost identical language that the Bankruptcy Court must treat the amount as interest and was, therefore, given no authority under Section 77 to reduce the amount.

In Point IV we point out that an argument advanced by the Trustees for the first time here with reference to the change in the law in 1941 is without merit.

Since we firmly believe that, had the Court below not followed the reasoning of the *Arkansas Corporation Commission* case, it still must have concluded that the Bankruptcy Court was, for certain reasons stated in the argument below, without power to make the requested adjudications concerning the tax liens of the State of New Jersey affixed at the time of bankruptcy and that, in case of a review, the result must be the same although perhaps such result might be based upon other grounds, we pray the indulgence of this Court in presenting at this time in our Point V an abbreviated version of our unanswered argument below concerning lack of jurisdiction under the following subpoints: (a) Section 64 does not authorize the Bankruptcy Court to make the requested adjudications; (b) Section 77 does not give such power; (c) Section 67 does not give such power; (d) since the liens of the State were affixed prior to bankruptcy, the Bankruptcy Court may not

make adjudications to be binding upon the State of New Jersey without the State's consent; and (e) the State of New Jersey has not consented to the making of such adjudications.

From the above, we shall urge that the petitioner has not shown a case warranting the issuance of the discretionary writ of certiorari.

ARGUMENT.

POINT I.

The Court below applied the applicable rule of law as set forth in *Arkansas Corporation Commission* vs. *Thompson*, 313 U. S. 132.

The Trustees by their petition of August 14, sought to have the Bankruptcy Court in a summary manner make adjudications concerning the several matters set forth in detail at page one of this brief and involving three broad questions: (1) the power of the Bankruptcy Court to adjudicate concerning the constitutionality and applicability of the "Settlement Acts"; (2) the power of the said Court to reduce the interest rate; and (3) the power of the said Court to re-determine the amount of the assessments.

But where in the Bankruptcy Act can we find the power in the Bankruptcy Court to make such adjudications in a summary manner? The Trustees urged below that Section 64 gives the said Court such power. Reference to the interim report of the standing master (T. pg. 163a) discloses that the Master found the power to make the said adjudications in the said Section 64.

As we will show in detail hereafter, it has been uniformly held that Section 64 does not apply to secured claims but only to unsecured claims, to those claims which but for the priorities given in the said section would have no priority

and would share only in the residual estate available for general creditors. Likewise there has been considerable doubt whether Section 64 applies in railroad reorganization proceedings under Section 77 in any event.

This problem was before this Court, although in a matter involving taxes accruing during bankruptcy, in *Arkansas Corporation Commission* vs. *Thompson*, 313 U. S. 132. In that case, which should be dispositive of the matter presently before this Court, this Court said that it was unnecessary to decide whether Section 64 applies in Section 77 proceedings because, conceding the applicability of the said Section 64, the Bankruptcy Court was still without jurisdiction to review the disputed tax assessments since an adequate judicial review was afforded by the laws of the taxing State. This Court held that the Bankruptcy Court should have dismissed the petition.

The Circuit Court of Appeals below construed the *Arkansas Corporation Commission* case in *In re Monongahela Rye Liquors*, 141 F. (2d) 864. The majority of the Court held that, where a judicial review of assessments is afforded by the local law, the Bankruptcy Court is limited to review for the purpose of (1) examining for mathematical error in the computation of the tax, or (2) legal error in the assessment. In an opinion which concurred in the result, Judge Biggs refused to apply the rule of the *Arkansas Corporation Commission* case but held instead that the facts of the *Monongahela Rye Liquors* case brought it within the rule of *New Jersey* vs. *Anderson*, 203 U. S. 483, which latter case was distinguished by this Court in the *Arkansas Corporation Commission* case.

It is difficult to read into the last mentioned case the exact construction placed upon it in the *Monongahela* case for the reason that this Court said in the former case that the question of the legality of taxing laws would in the orderly course of events come before the Federal Court by way of review of the judgments of the State Court of last

resort. However, it is unnecessary to decide this question because Judge McLaughlin below in applying the rule of *Arkansas Corporation Commission* vs. *Thompson, supra,* as construed by the *Monongahela* case, applied a further factor, the determinations by the Third Circuit, adversely to the Trustees' debtor, in *Lehigh Valley* vs. *Martin,* 100 F. (2d) 139, *supra,* and *Central Railroad* vs. *Martin,* 115 F. (2d) 968, *supra,* which dealt with the legality of the assessments. This, of course, eliminated the second portion of the above mentioned rule of the *Monongahela* case and left only the power to review for mathematical error in computation.

The Court below did not pass upon the several questions raised by the State concerning the applicability of the several sections of the Bankruptcy Act to the tax liens of the State affixed prior to bankruptcy and concerning the State's right to be immune from suit with respect to such liens unless the State consents for the reason that the determination of such questions were deemed by the Court to be wholly unnecessary.

Just as this Court in the *Arkansas Corporation Commission* case said that it was unnecessary to determine whether or not Section 64 applied to Section 77 reorganization proceedings for the reason set forth therein, so Judge McLaughlin in effect said that it is unnecessary to determine the applicability of Sections 64 and 77 to liens which were affixed at the time of bankruptcy or to determine the question of whether or not the present petition in fact constituted the institution of a suit against the State, for the reason that, conceding that all of these questions should be decided adversely to the State of New Jersey, yet the Bankruptcy Court under the facts and law of the instant case only had power to review the assessments made by the State of New Jersey to determine whether or not there was mathematical error in the computations.

As was obviously recognized by the Court below, our case is even stronger than the *Arkansas Corporation Commission* case because the debtor herein actually had litigated in the State and Federal Courts all questions concerning the legality of the New Jersey taxing methods. In the said case, at page 144, this Court said:

> "If the trustee had availed himself of his right of appeal to the courts of Arkansas, with an ultimate right of appeal to this Court for final determination of federal questions, it is difficult to believe that it would now be seriously argued that Congress, by § 64 (a) (4), intended to impose upon the bankruptcy court the unusual power and delicate duty of trying out afresh the facts found by the state with relation to the value of property. And there is no more reason to assume that Congress intended that the bankruptcy court should fail to give respect to an unappealed determination of value made by the Arkansas Corporation Commission."

The present case involves a factual situation similar to that suggested by this Court in the above statement as being difficult of belief. It is wholly inconceivable that anyone may now seriously contend that, in the light of the litigation that has gone before concerning the 1932-1939 taxes of the debtor, there exists in any court a right to review the New Jersey tax assessments for such years. It seems obvious that the Trustees by their petition of August 14, with its welter of conflicting matters, claims and complaints, have sought, under the guise of a review of the tax assessments, actually to obtain in a summary manner in the Bankruptcy Court a review of a determination by the New Jersey Court of Errors and Appeals that the so-called Settlement Acts are unconstitutional and an adjudication

on the question whether, notwithstanding such unconstitutionality, this debtor may still avail itself of certain benefits intended to be afforded by such acts.

It appearing therefore that the jurisdiction of the Bankruptcy Court in our particular case extends only to a determination whether there is mathematical error in computation, we ask ourselves the following: Does the answer to the first prayer contained in the petition of August 14, concerning the existence of a contract with the State of New Jersey, involve the determination of such mathematical error? The answer is obviously in the negative. And so with each of the other prayers contained in the said petition. Not one concerns itself with the determination of mathematical error. It follows therefore that the Bankruptcy Court improperly assumed jurisdiction with respect to the several matters sought to be adjudicated in the said petition for adjudication, and the Court below following the rule laid down in *Arkansas Corporation Commission* vs. *Thompson, supra,* quite properly reversed the judgment of the lower Court.

POINT II.

Regardless of the rule of *Arkansas Corporation Commission* vs. *Thompson, supra,* the Bankruptcy Court was required to follow *In re Central Railroad Company of New Jersey,* 136 Federal (2d) 633, *supra,* with respect to the applicability of the Settlement Acts and so was without jurisdiction to make the adjudications requested by the Petition of August 14.

As stated above, the New Jersey Legislature sought to forgive certain railroad companies the payment of interest due to the State on account of default in payment of railroad taxes in the years 1932 to 1940, inclusive. By Chapter 291 of the Laws of 1941, provision was made for the approval of the Attorney-General to certain documents required in order to accomplish a settlement under the

terms of the said Act. Conceiving the said Act to be unconstitutional, the Attorney-General refused to participate in the settlement procedure but instead, on September 4, 1941 (barely six weeks after the passage of the Act), filed an information in the New Jersey Chancery Court in order to obtain a determination as to the constitutionality of the said Settlement Act.

On May 21, 1942, the New Jersey Legislature amended the 1941 Act to provide a settlement procedure which did not require the participation of the Attorney-General, this notwithstanding the pendency of the just mentioned litigation (Chapter 241 of the Laws of 1942). On the very same day that the amendatory act was passed, the New Jersey Chancery Court issued its injunction prohibiting the fiscal officers of the State from accepting any money or tender pursuant to the terms of the Settlement Acts pending the determination of the constitutional question. On July 20, 1943, the Settlement Acts were held unconstitutional in *Wilentz* vs. *Hendrickson*, 133 N. J. Eq. 447. This judgment was affirmed by the New Jersey Court of Errors and Appeals on June 22, 1944 (135 N. J. Eq. 244). The injunction was thereupon made permanent.

In the meantime and about June 2, 1942, the Trustees for the Debtor filed a petition with the Bankruptcy Court requesting instructions concerning the acceptance of the terms of the Settlement Acts and requesting that an order be entered fixing the amount due to the State of New Jersey on account of taxes due for the years 1932 to 1940. The Bankruptcy Court by its Order No. 163 proceeded to determine that there was due to the State of New Jersey on account of the said tax obligation only that amount of money required under the terms of the Settlement Acts, this notwithstanding that the said Settlement Acts were presently in litigation and the fiscal officers of the State were restrained from accepting any moneys or documents pursuant to the terms of the said Acts. The Circuit Court

of Appeals below reversed the said order in *In re Central Railroad Company of New Jersey*, 136 Fed. (2d) 633, *supra*, holding that:

> "It would, therefore, have been appropriate, in the exercise of a wise discretion for the District Court to have staid its hand until the State Court had determined whether the Tax Settlement Acts were valid or a nullity."

The Trustees' application for a writ of certiorari to review this determination was denied by this Court (320 U. S. 805).

In the course of the just mentioned controversy, the Trustees advanced the same arguments which they are presently using to support their allegation that the Settlement Acts are binding as to them. They urged that there was a binding contract between the State of New Jersey and themselves and that they had fully performed. The conclusion of the Court below on this matter is set forth at page 638 of the just mentioned opinion as follows:

> "The final contention that the issue between the State and the Trustees is moot by reason of the tender to the Treasurer of a payment pursuant to Order No. 163 must also fail. The tender though acknowledged was not accepted by the Treasurer and consequently was without legal effect. In fact the Treasurer was powerless to accept the tenders by reason of the injunction issued by the Court of Chancery."

It is inconceivable that the Circuit Court of Appeals could have intended that the District Court should have, in the exercise of a nice discretion, waited to learn the views of the New Jersey Court on the question of constitutionality, unless the said Circuit Court of Appeals intended, since only the construction of a State statute was involved, that the District Court would be bound by the result. It is

wholly illogical that it could have intended that the said District Court would have been bound only if the matter were determined in favor of the Trustees and adversely to the State of New Jersey.

The case of *Wilentz* vs. *Hendrickson*, 135 N. J. Eq. 244, *supra*, was fairly litigated and the said litigation covered the railroad taxes of all the defaulting railroad companies, including the present Trustees. Of particular significance is the fact that the New Jersey Legislature sought vainly to remedy certain obvious unconstitutional defects in order to assist the defaulting railroad companies.

In this connection it should be pointed out that the Trustees stood by while the said litigation was pending and made no effort to be heard therein. This attitude continued even after they had learned the view of the United States Circuit Court of Appeals as expressed in *In re Central Railroad Company of New Jersey*, 136 Fed. (2d) 633, *supra*, at a time when there was still ample time to have intervened in the argument before the New Jersey Court of Errors and Appeals. Also it must be remembered that equitable principles prevail in the application of the provisions of the Bankruptcy Law. Equity favors the diligent and looks with disfavor upon one who withholds his action in the hope that by his own inaction he may obtain a sharp advantage. The Trustees were aware of every step that was being taken in the course of that litigation and can not be heard to complain now on the score that the result might have been different had they seen fit to intervene.

The Trustees have pointed to no provision of the Bankruptcy Act which gives the Bankruptcy Court the power summarily to relitigate the subject matter of the controversy presented by *Wilentz* vs. *Hendrickson*, *supra*, and by in *In re Central Railroad Company of New Jersey*, 136 Fed. (2d) 633, *supra*. The Court below quite properly refused to find jurisdiction in the Bankruptcy Court to make the requested adjudications concerning the Settlement Acts.

The Trustees have shown no compelling reason why this Court should issue its discretionary writ of certiorari for the purpose of reviewing this particular phase of the matter upon which the Trustees seem to place such stress.

POINT III.

Regardless of the rule of *Arkansas Corporation Commission* vs. *Thompson*, the Bankruptcy Court was bound by the rule established by this Court in *Meilink* vs. *Unemployment Reserves Commission*, 314 U. S. 564, denying jurisdiction in the Bankruptcy Court to define as a penalty that denominated as interest under State law in order to apply section 57.

The Trustees in their present petition (Pet. pg. 14) state,

> "Incidental questions arise whether, because of the facts and circumstances of this case the Bankruptcy Court should not in any event exercise its equity jurisdiction to do equity (Section 77 (A) and Section 2-a of the Bankruptcy Act), by determining that in no event should the State's claim carry penalty interest at 1% per month * * *."

The Trustees can gain nothing by designating the interest charged by the State of New Jersey as penalty. There can be no doubt but that the charge is interest under the decisions of this Court. It is provided in Section 57 that debts owing to the United States or any State or subdivision thereof as a penalty or forfeiture shall not be allowed except in a restricted amount. The Bankruptcy Act does not give any power to the Bankruptcy Court to reduce the amount of interest as distinguished from a penalty or forfeiture.

This question is not new but on the contrary was before this Court and determined adversely to the contentions of the Trustees in *Meilink* vs. *Unemployment Reserves Commission*, 314 U. S. 564. In that case it was determined that one per cent (1%) per month charged by the California Unemployment Reserve Act was interest as distinguished from penalty and was not improper. This Court said in that case at page 569:

> "We must give credit to a state legislature acting within its constitutional sphere like that accorded to Congress acting in its constitutional sphere."

Our case is on all fours with the *Meilink* case. The New Jersey Statutes provided (Section 54:27–4):

> "If the taxes of any company, or any portion thereof, remain unpaid on December first following the levying thereof, the company shall be considered in default, and such taxes, or the unpaid portion thereof, shall thenceforth bear interest at the rate of one per cent for each month until paid, notwithstanding the prosecution of a writ of certiorari or other remedy."

Reference to the statute shows that uniformly the charge for interest on account of default is designated as interest and not a penalty. Furthermore there is a provision for penalty in the Act and it is called a penalty. Section 54:23–4 provides for a fixed penalty, regardless of the time element, in the event of the making of a wilful return to the State Tax Department. (There is no question of any such penalty being claimed in this case.) The New Jersey Legislature has strictly maintained the distinction between interest and penalty which is required by the rule laid down in the said *Meilink* case, *supra*.

But in addition, the New Jersey Court of Errors and Appeals in *Wilentz* vs. *Hendrickson,* 135 N. J. Eq. 244, *supra,* has determined that the amount is interest as distinguished from penalty and in arriving at that conclusion cited the just mentioned *Meilink* case (pg. 256).

It follows, therefore, that there is presently no doubt as to the state of the law on the interest question. The *Meilink* case was before the Court below and had that Court not rested its determination on the *Arkansas Corporation Commission* case, it must have found that the Bankruptcy Court was without jurisdiction to make any determination reducing the rate of interest and that the said Court was required to follow the law of the State of New Jersey.

POINT IV.

The argument of the Trustees with reference to the effect of the change in the Railroad Tax Law in 1941 is without merit.

The Trustees have pointed out that by R. S. 54:27–4 (in effect prior to 1941) a lien was given upon the lands and tangible property and franchises of the company in this State. They then point out that the new law in R. S. 54:29A–54 provides that the lien shall be upon,

> "The revenues and all the real and personal property owned, used or controlled by the taxpayer within this State."

The Trustees failed to point out a very necessary part of the Act which provides in Section 54:29A–74 that:

> "This act (chapter) shall be construed as a revision of chapters nineteen through twenty-nine inclusive, of Title 54 of the Revised Statutes, and nothing herein shall be construed to affect any pending litigation, nor

to repeal, abate, cancel, cause to lapse or otherwise affect in any manner any assessment or the lien or obligation to pay any taxes heretofore assessed to any taxpayer, or the legal authority to collect taxes, interest and penalties which have accrued under any provision of law repealed by this act (chapter) or under any other law, except as specifically provided in this act (chapter), or to affect the right of the state tax commissioner to assess omitted property, and apportion the tax so assessed, for any year prior to one thousand nine hundred and forty-one, according to the classification and at the rates prescribed in the chapters aforesaid."

The Trustees, now have for the first time in their present petition to this Court, raised the question that the change in the railroad tax law in 1941 may have caused the State's lien to lapse. Their failure to raise this question during nearly five years of litigation speaks eloquently and is compelling proof of the lack of merit in that contention.

But again we point out that, while throwing out the just mentioned suggestion, the Trustees have shown no power in the Bankruptcy Court to adjudicate such question in a summary manner. Furthermore if the Court should undertake the determination of such matter, it would be bound by the clear provision of the law set out above, which the Trustees, in their brief, failed to mention.

POINT V.

If the Court below had not followed the *Arkansas Corporation Commission* case, it nevertheless must have found that the Bankruptcy Court was without jurisdiction, unless the State should consent thereto, to make adjudications, intended to be binding upon the State, concerning tax liens affixed at the time of bankruptcy.

As we have pointed out, the Court below in its wisdom rested its determination of the jurisdictional question upon a practical exposition of the rule of the *Arkansas Corporation Commission* case as applied to the facts of the instant case instead of upon certain other jurisdictional grounds which would have denied jurisdiction in the Chancery Court to make any adjudication whatsoever concerning the existing tax liens of the State of New Jersey. Since it is our belief that there can be substantial disagreement with the Court below only as to the reasoning for attaining its result and not in anywise with the result itself, we pray the indulgence of this Court in submitting this point which goes rather to the merits of the controversy, for the purpose of showing that a review of this case could only result in an affirmance of the judgment below for the reasons stated by the Court below or an affirmance on one of the grounds now to be set forth.

a. *Section 64 of the Bankruptcy Act does not authorize the Bankruptcy Court to adjudicate concerning the tax liens of the State of New Jersey.*

Section 64 does not apply to tax liens. It applies only to certain priorities given to unsecured claims of persons who except for the said section would have no priority in such assets. *Miners' Savings Bank of Pittston* vs. *Joyce,*

97 F. (2d) 973 (C. C. A. 3rd, 1938); *Ingram* vs. *Coos County*, 71 Fed. (2d) 889 (C. C. A. 9th, 1934); *In re Brannon*, 62 F. (2d) 959 (C. C. A. 5th, 1933), cert. den., 289 U. S. 742, sub. nom. *Ryan* vs. *City of Dallas*; *In re Knox-Powell-Stockton Co.*, 100 F. (2d) 979 (C. C. A. 9th, 1939); *Strom* vs. *Peikes*, 123 F. (2d) 1003 (C. C. A. 2d, 1941); *In re Weil*, 46 F. Supp. 14 (D. C. Pa. 1942); *In re Wilkes-Barre & E. R. Co.*, 46 F. Supp. 12 (D. C. Pa. 1942).

In *In re Brannon*, 62 F. (2d) 959 (C. C. A. 5th, 1933), cert. den., 289 U. S. 742, sub. nom. *Ryan* vs. *Dallas*, the Court stated the rule at page 960:

> "Section 64 gives the rule for paying out the money arising from the bankrupt's property which remains for general distribution after all special liens and encumbrances have been dealt with. * * * On the other hand, where the creditor before the bankruptcy has an established lien on the bankrupt's property which binds it as to third persons and which is not invalidated by the bankruptcy, he does not come under the operation of section 64."

b. *Section 77 does not give the Court jurisdiction to deal with the tax liens of the State.*

Nowhere in Section 77 do we find any mention of taxes. If the Courts had found that Congress intended to include the power to review taxes there would have been no need of reading into the said Section 77 proceedings the provisions of Section 64. The said Section 77 deals with the reorganization of a railroad. All of the definitions stem out of the definition of the word "creditor." This Court and the Courts generally have held that the obligation to pay taxes does not create the ordinary debtor-creditor relationship. It is with such debtor-creditor relationship with which the Congress has dealt in Section 77.

It is admitted that during the time that it is necessary to determine whether or not a railroad will be able to reorganize under private ownership, the officers of a State may be enjoined from foreclosing any equity of redemption. And that is the limit of the power. If it is made to appear when the time comes to submit a plan of reorganization that the taxes will not be paid in full, then the conclusion must be reached that reorganization is hopeless. Congress could never have intended that a State which has been denied its taxes and interest for a considerable period should be required to take securities of railroad companies and go into the railroad business without its consent.

Congress throughout the Bankruptcy Act has consistently demonstrated a policy and purpose to preserve the rights of States and State taxing agencies in the operation of the provisions of the Bankruptcy Act. A construction of Section 77 which would require the State to submit its lien claims to the Bankruptcy Court or have those tax liens wiped out is wholly contrary to such demonstrated policy. We therefore believe that it was not intended that Section 77 should give the Bankruptcy Court power to adjudicate concerning the tax liens of the State of New Jersey which were affixed prior to bankruptcy without the State's consent.

c. *Section 67 does not give the Bankruptcy Court the power to make the requested adjudications.*

The Trustees here for the first time set forth Section 67 as the source of the power to make the requested adjudications concerning the tax liens of the State which were affixed prior to bankruptcy. This debtor filed its petition on October 30, 1939. The taxes for the years 1932 to 1939 became a lien on June 1, of each respective year, the latest

becoming a lien on June 1, 1939, more than four months prior to bankruptcy. It was provided by Section 54:27-4 that:

> "These taxes shall be a lien paramount to all other liens upon all of the lands and tangible property and franchises of the company in this State."

Nothing further was required to be done by the State in order to have the lien attach. That this is so is clearly borne out by Section 54:28-5 providing for sale to enforce the State's tax lien. With respect to property not used for railroad purposes, the Legislature provided as follows:

> "As to any other property of the company or persons, the judgment and execution shall constitute or become liens in the same manner and to the same extent as other judgments and executions of the Supreme Court."

As stated above, the Trustees did not urge the applicability of this section below but raise it here for the first time. It is obvious that since no further action is required by State law to perfect the lien, the said section does not give authority to make the adjudications requested. With reference to the subordinating of the State's lien upon certain personal property for the purpose of paying debts specified in "clauses 1 and 2" having to do with administrative expenses and wages, we point out that, until the need is found for resort to such assets, the question is not properly before the Court. This section discloses clearly that Section 64 does not apply ordinarily in a case where the State does have liens affixed at the time of bankruptcy.

d. ***Since the liens of the State were affixed prior to bankruptcy, the Bankruptcy Court may not make adjudications to be binding upon the State concerning such liens without the State's consent.***

1. ***The Bankruptcy Court may not adjudicate concerning perfected liens without first acquiring jurisdiction over the lienholder.***

It is fundamental that the Bankruptcy Court takes custody of the property of a bankrupt in the same "plight and condition" in which the bankrupt himself held such property at the time of bankruptcy. *Thompson* vs. *Fairbank*, 196 U. S. 516. A trustee takes property of a bankrupt subject to whatever liens existed as against the bankrupt. *Rode & Horn* vs. *Phipps*, 195 F. 414 (C. C. A. 6th, 1912). In *Marshall* vs. *New York*, 254 U. S. 380, 385, the Court said:

> "* * * a receiver appointed by a federal court takes property subject to all liens, priorities or privileges existing or accruing under the laws of the State * * *"

Since the Bankruptcy Court takes property subject to liens, it follows that before the Court can make any adjudications concerning the interest of a lienholder, it must obtain jurisdiction over that lienholder. It was so held in *Factors' & Traders' Insurance Co.* vs. *Murphy*, 111 U. S. 738, where the Court said at page 742:

> "We are of opinion, with the Supreme Court of Louisiana, that the record in this case does not show such service of process or other notice as makes Mrs. Murphy such a party to the bankruptcy proceeding as binds her to the sale and discharges her lien. The case of *Ray* vs. *Norseworthy*, 23 Wall. 128, is conclusive on that subject, and is, we think, sound in principle."

The rule could not be otherwise, else the constitutional rights of a lienholder would be violated. As was said in *Louisville Joint Stock Land Bank* vs. *Radford*, 294 U. S. 553:

> "The bankruptcy power, like the other great substantive powers of Congress, is subject to the Fifth Amendment."

2. *Since it is necessary to obtain jurisdiction over the person of the lienholder, this may not be done where the lienholder is a state unless the state consents.*

In *Arkansas Corporation Commission* vs. *Thompson*, 313 U. S. 132, 145, it was said:

> "But there is nothing in the history of bankruptcy or reorganization legislation to support the theory that Congress intended to set the federal courts up as super assessment tribunals over state taxing agencies."

We do not need to cite authority for the rule that a sovereign state may not be sued without its consent in a Federal Court. A clear statement of the basis for the rule is to be found in *Great Northern Life Insurance Co.* vs. *Read*, 322 U. S. 47, at pages 51 and 54,

What constitutes a suit against a state is not circumscribed within any narrow or technical limits. In *State of Missouri* vs. *Fiske*, 290 U. S. 18, the Court held that the immunity of a State from suit extends to any proceedings wherein process is issued against a state

> "to compel it to subject itself to the court's judgment, whatever the nature of the suit,"

In *Minnesota* vs. *United States,* 305 U. S. 382, a proceeding against property in which the sovereign had an interest was prohibited. In *Worcester County Trust Co.* vs. *Riley,* 302 U. S. 292, a bill of interpleader was held to come within the prohibition.

In *Palmer* vs. *Ohio,* 248 U. S. 32, 34, this Court said:

> "The right of individuals to sue a state in either a federal or a state court, cannot be derived from the Constitution or laws of the United States. It can come only from the consent of the state."

The rule is well stated in *Ex-Parte State of New York,* 256 U. S. 490, wherein it was claimed that the Federal Courts had jurisdiction because an admiralty question was involved. The Court said in *Missouri* vs. *Fiske, supra,* pg. 28.

> "The fact that a suit in a federal court is in rem, or quasi in rem, furnishes no ground for the issue of process against a non-consenting State. If the State chooses to come into the court as plaintiff, or to intervene, seeking the enforcement of liens or claims, the State may be permitted to do so, and in that event its rights will receive the same consideration as those of other parties in interest. But when the State does not come in and withholds its consent, the court has no authority to issue process against the State to compel it to subject itself to the court's judgment, whatever the nature of the suit."

e. *The State has not consented to such suit.*

(1.) *No New Jersey statute or constitutional provision authorizes the participation of the State in Section 77 proceedings in a case where it has liens for its taxes.*

The Trustees have been unable to point to any New Jersey statute or constitutional provision authorizing any officer of the State to consent to the State's participation in these proceedings with respect to its tax liens. No such provision exists. *Strobel Steel Construction Company* vs. *State Highway Commission,* 120 N. J. L. 298. The New Jersey law, as the applicable local law, is conclusive on the subject of consent to be sued. *Palmer* vs. *Ohio, supra.* The State Comptroller was not authorized to prosecute the enforcement of the State's tax liens in this or any other proceeding, nor was he authorized to consent to any adjudication concerning such tax liens.

Since the Comptroller possessed no authority to enforce the lien claims in question, no action by him in these proceedings can be construed as a demand by the State for the enforcement of those liens by this Court. *Minnesota* vs. *U. S., supra; Adams* vs. *Bradley,* 1 Fed. Cases 93, 5 Sawy. 217, 219 (C. C. 1878); *O'Connor* vs. *Slaker,* 22 F. (2d) 147, 152 (C. C. A. 8th 1927); *Title Guarantee & Surety Co.* vs. *Guernsey,* 205 Fed. 94, 95 (D. C. Wash. 1913).

This Court was requested to pass upon the extent of the power of an officer to bind the State in *Ford Motor Company* vs. *Dept. of Treasury of Indiana,* 65 Sup. Ct. Rep. 347 (January 8, 1945). In that case the State's immunity from suit was raised for the first time in this Court.

(2.) *The filing of the proofs of claim merely constituted a notification to the Court and Trustees of the existence and amount of the State's liens and was not a proceeding to enforce the liens.*

It is fundamental in the law of bankruptcy that a claimant must exhaust his security before he can assert a claim against the assets that are in the custody of the Court. *In re Hagin*, 21 Fed. (2d) 434; *New York Trust Co.* vs. *Palmer*, 101 Fed. (2d) 1.

This being the rule and it likewise being the rule that

> "a claim proven as a secured claim is always potentially an unsecured one. If the security fails in whole or in part the equity of the case will generally require that recognition be given the unsecured debt." *McAbee* vs. *Isom*, 116 Fd. (2d) 1001 (C. C. A. 5th 1940.)

the only power that may be attributed to the Comptroller in the instant case has to do with a claim that he may be required to make in the eventuality that the security afforded by the lien should not be sufficient to liquidate the whole tax debt and it should become necessary to make a claim for a deficit.

The Comptroller could not make any estimate as to the amount of any such deficit, since the New Jersey Attorney-General was restrained by the Bankruptcy Court from enforcing the tax liens—the only method given by law whereby the amount of the deficiency claim that the State might ultimately have against the general assets might be proved.

As stated in *Henderson County* vs. *Wilkins*, 43 F. (2d) 670, 672 (C. C. A. 4th, 1930), in speaking of the action of the Court concerning a review of tax claims against the general assets:

> "Its action is not a review of the action of the taxing authorities or a proceeding to enjoin action by them, but a determination under the statute of the amount which should be paid on the claim for taxes from the assets of the estate in its possession. *In re E. C. Fisher Corporation* (*D. C.*), 229 F. 316, 318."

In conclusion of this point, we urge therefore that the Bankruptcy Court did not have the power to make the adjudications requested by the petition of August 14, for the reason that either Congress had not given such power by any provision of the Bankruptcy Act, or if Congress had intended to grant the power to make such adjudications without the State's consent, such grant of power was unconstitutional. Congress was without power to give the Court jurisdiction to make adjudications with respect to tax liens affixed at the time of bankruptcy without the State's consent if such adjudications are intended to be binding upon such State.

CONCLUSION.

It is respectfully submitted that this case involves no matter properly warranting the granting by this Court of the discretionary remedy of review by certiorari and that the prayer for the issuance of the writ of certiorari should be denied.

Respectfully submitted,

WALTER D. VAN RIPER,
Attorney-General,
Attorney for State of New Jersey, Respondent.

BENJAMIN C. VAN TINE,
Of Counsel.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1946

No. 92

WALTER P. GARDNER, Trustee of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY,
Petitioner,

vs.

STATE OF NEW JERSEY,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF OF RESPONDENT, STATE OF NEW JERSEY.

WALTER D. VAN RIPER,
Attorney-General of New Jersey,
Attorney for Respondent,
State House, Trenton, N. J.

BENJAMIN C. VAN TINE,
Of Counsel.

November 27, 1946.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1946

No. 92

WALTER P. GARDNER, Trustee of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY,

Petitioner,

vs.

STATE OF NEW JERSEY,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF OF RESPONDENT, STATE OF NEW JERSEY.

I.

OPINIONS BELOW.

The opinion of the Circuit Court of Appeals for the Third Circuit is reported in 152 Fed. (2d) 408. It is printed in the Record (pg. 148). The opinion of the District Court of the United States for the District of New

Jersey, confirming the Special Master's Interim Report (R. 27), which was reversed by the Circuit Court of Appeals, is not officially reported but appears in the Record (pg. 40).

II.

JURISDICTION.

The petitioner has stated that the jurisdiction of this Court is invoked under the Act of February 13, 1925, C. 229, Sec. 1, 43 Stat. 938; USCA Tit. 28, Sec. 347. The State of New Jersey has not denied the power of this Court to entertain the review in the instant case.

III.

STATEMENT OF THE CASE.

On August 14, 1944, the Trustees of the Debtor, in reorganization under Section 77 of the Bankruptcy Act, filed a petition entitled "Petition for Adjudication Concerning New Jersey State Tax Claims and for Order No. 250," which we shall hereinafter refer to as the petition of August 14 (R. pg. 43). That petition prayed (R. pg. 62):

> "that this Honorable Court, the premises considered, may promptly adjudicate (1) whether petitioners entered into a contract with the State of New Jersey, (2) whether such contract is binding on the parties thereto, (3) whether, if not binding on the State, petitioners are nonetheless bound by the prejudicial actions taken by them, (4) if not binding on the parties thereto including petitioners, to what extent, if at all, the proofs of claim of the State of New Jersey should be allowed, (5) what order should in such event be made to restore the equivalent of the status quo ante as nearly as may be and (6) what in such event are the relative rights, claims, liens and priorities of the

claimants in the assets of the Debtor's Estate; and that this Honorable Court may instruct petitioners whether to make on or before December 1, 1944, the additional payment on account of the taxes claimed and the additional interest payment required by Chapter 290 of the Laws of 1941, as amended by Chapter 241 of the Laws of 1942."

Being of the opinion that the Bankruptcy Court was wholly without jurisdiction to entertain such petition for the reason that (1) there is no power in the Bankruptcy Court summarily to review the matters and make the determinations or adjudications requested by said petition, and that, even if there were such power (2) the making of such determinations and adjudications concerning liens of the State affixed at the time of bankruptcy constitutes a suit against the State which may not be maintained without the State's consent, the State of New Jersey appeared specially and moved to dismiss the said petition of August 14.

The Bankruptcy Court's finding that the requisite jurisdiction did exist was reversed by the Circuit Court of Appeals in *In re Central Railroad of New Jersey*, 152 F. (2d) 408. That judgment is before this Court for review upon application of the Trustee of the Debtor, hereinafter referred to as the Petitioner.

To understand the questions presently before this Court and in order to determine the applicability of the several sections of the Bankruptcy Act to the matters presently in controversy, a detailed statement of the prior litigation is deemed necessary.

A. *Concerning the litigation with respect to the assessment of the 1932 to 1939 taxes.*

The current controversy concerning the assessment methods employed by the taxing authorities in the State of New Jersey actually began with the review of the 1931

assessments. The New Jersey Supreme Court denied a request for a reduction in the 1931 assessments in *Central Railroad Company of New Jersey* vs. *State Board of Tax Appeals,* 109 N. J. L. 395. The New Jersey Court of Errors and Appeals affirmed this judgment (112 N. J. L. 5) and certiorari was denied by this Court (293 U. S. 568). The 1931 taxes have been paid.

The Debtor appealed its 1932 assessments to the State Board of Tax Appeals. The assessments were affirmed after hearing. No application was made to the New Jersey Supreme Court for a review of that judgment.

The Debtor appealed its 1933 assessments to the State Board of Tax Appeals. These assessments were affirmed after hearing. The Debtor was then granted a review of the 1933 assessments by the New Jersey Supreme Court. On December 11, 1934, the Supreme Court affirmed the judgment of the State Board in *Central Railroad Company* vs. *Martin,* 114 N. J. L. 69.

No appeal was taken to the New Jersey Court of Errors and Appeals from such judgment, but instead this Debtor and certain other railroad companies brought suit in the United States District Court for the District of New Jersey, seeking a permanent injunction against the collection by the State of New Jersey of a portion of the taxes assessed against them for the years 1932 and 1933. The dismissal by the District Court of their application was affirmed by the Circuit Court of Appeals in *Lehigh Valley Railroad Company* vs. *Martin,* 100 F. (2d) 139, decided November 15, 1938. Application for certiorari was denied by this Court on April 19, 1939 (306 U. S. 651, rehearing denied 306 U. S. 669).

Thereafter, the Attorney-General of New Jersey started proceedings to enforce the State's lien for taxes for the said years 1932 and 1933. According to the Trustees' petition of August 14, the Attorney-General's action forced the filing of the Debtor's "Petition in Bankruptcy" (R. pg. 45 (4)).

Notwithstanding that all questions concerning the amount of the 1932 and 1933 taxes had been determined adversely to the Debtor and notwithstanding that the bankruptcy act gave power to the Trustees to borrow on Trustees' certificates, in a market which this Court will judiciously notice was asking a very low interest rate, the Trustees continued to resist the collection of the said taxes and allowed further interest to accumulate at 1% per month from October 30, 1939, which condition existed at the time of the argument below and continued to exist on April 18, 1946, when the Petition for Certiorari was filed in this Court.

On April 26, 1946, a very substantial payment was made in order to stop the running of some portion of the interest. Reference to the Record (pg. 298) will show that the State did not intend to waive its immunity or to relinquish any other right except as specifically set forth in Order No. 333. (R. pg. 296.) An impossible situation had been created by reason of the inability of the parties to devise a formula which would protect the State and at the same time permit this Debtor to make a payment in a way to stop the running of some portion of the said interest amount, particularly in view of the fact that the said Debtor had millions of dollars in cash in the bank or in negotiable bonds. The Bankruptcy Court of its own motion had called many conferences to determine some formula, reference to one of such in September, 1944, being mentioned by the Honorable Judge in the Record (pg. 307). It is worthy of note that the bondholders who have filed a brief amici curiæ in this cause, hereinafter called the bondholders, urged the payment of the said sum (R. pg. 316).

It is hard to believe that the petitioner in the instant case would seriously advance the argument that the State had intended to waive any right or that it had not adequately protected its position when it accepted payment pursuant to the terms of the said Order No. 333. Before

the Court was even presented with the Order the learned Judge said (R. pg. 317):

> "I now rule that I intend and will recommend payment; the amount is open until the coming in of the presentation of an order after counsel have examined it, and then if there are objections to that order I will hear them. I want to finish this today, time is money in this case."

Reading this in the light of the testimony presented at the said hearing wherein an exhibit was introduced entitled "Elements of Value of the Physical Property of the Central Railroad Company of New Jersey Based Upon Interstate Commerce Commission Calculations" on the basis of which the fixed property in New Jersey is valued at $123,248,161.00 (R. pg. 303), and the equipment allocatable to New Jersey at $36,093,044.00, it becomes apparent that the payment was made in order to protect the equity of the bondholders and others in the railroad properties obviously valued far in excess of the State's tax liens.

Notwithstanding what had been said by the New Jersey courts in the 1931 and 1933 cases, and by the Circuit Court of Appeals with reference to the combined 1932 and 1933 cases, nevertheless this Debtor and other railroad companies appealed their 1934, 1935 and 1936 assessments to the State Board of Tax Appeals. No reviews of the judgments of the State Board for the years 1934, 1935 and 1936 were sought from the New Jersey Supreme Court in the manner provided by statute, but the said Debtor and the other railroad companies again resorted to the Federal Courts. The United States District Court entered a decree enjoining the collection of more than 60% of the 1934, 1935 and 1936 assessments until a revaluation of the property should be made by the State taxing authorities in conformity with the opinion of the said District Court. This was

later increased to 70%. Upon appeal by the State, the judgment was reversed in *Central Railroad Company* vs. *Martin*, 115 F. (2d) 968, decided November 27, 1940.

The Circuit Court of Appeals in reversing the judgment in the last mentioned case held that all questions concerning the assessment methods employed in connection with the 1934, 1935 and 1936 taxes had been made res judicata by *Central Railroad* vs. *Martin*, 114 N. J. L. 69, *supra*,—by the judgment of the New Jersey Supreme Court in connection with the 1933 assessments.

By their petition of August 14, the Trustees deny that they were a party to the appeal before the United States Circuit Court of Appeals. Reference to the record in that case will show, however, that the Debtor did appear in the proceedings and that the injunction running against the State and to the said Debtor was dismissed. The Circuit Court of Appeals issued its mandate to the District Court specifically setting aside the decree in favor of this Debtor. It is worthy of observation that the reported case shows that counsel in the Circuit Court of Appeals' case was one of those whose name appears upon the brief in the present action. A copy of the mandate is shown in the appendix to this brief (pg. 147) as well as a notice filed by the Petitioner in the Bankruptcy Court on December 27, 1945 (App., pg. 149) concerning such mandate.

The Debtor did not apply for certiorari to review this judgment. The New York, Susquehanna and Western Railroad Company, a party to the proceedings before the Circuit Court of Appeals and which is also under Section 77 reorganization proceedings, likewise did not seek certiorari. Judge Clark, who sat in the New York, Susquehanna and Western case, said with reference to further proceedings concerning such taxes, as reported in 36 Fed. Supp. 158, 160:

> "We insist upon a proscription of futility."

All of the other railroad companies, with the exception of the two just mentioned, sought certiorari from this Court which was denied on April 28, 1941 (313 U. S. 568).

Again we call attention to the fact that notwithstanding what was said in that case, a large amount of 1934, 1935 and 1936 taxes were still due to the State of New Jersey at the time of the filing of the petition for certiorari in this case.

The Debtor and other railroad companies appealed their 1937 and 1938 assessments, which were at exactly the same level as the 1936 assessments, to the State Board of Tax Appeals. The two years were heard as a unit and an aggregate of 4,610 pages of testimony were taken and 450 exhibits were introduced into evidence. The assessments were affirmed by the State Board on May 13, 1941. Since the identical assessing method was employed, *Central Railroad* vs. *Martin*, 115 F. (2d) 968, *supra* must be controlling and it must be the law of these latter years that all questions concerning the assessment method for such years had likewise been made res judicata by *Central Railroad* vs. *Martin*, 114 N. J. L. 69, *supra*. *Tait* vs. *Western Maryland*, 289 U. S. 620, 624, and *Central Railroad Co.* vs. *Martin*, 115 F. (2d) 968, 973, *supra*.

It was not the passage of the "Settlement Acts" which caused the railroads to refrain from again resorting to the certiorari procedure provided by our statutes or to the Federal Courts in the manner set forth above as alleged by the Petitioner. They had exhausted every remedy that promised even a possibility of success and were confronted with the situation which caused the learned Judge in the *Susquehanna* case to make the classic remark concerning a "proscription of futility." (36 Fed. Sup. 158, 160.)

The Debtor appealed its 1939 assessment to the State Board of Tax Appeals. In that year the State Tax Commissioner made primary valuations substantially the same as those in 1938. On a review of the primary assessment

provided by statute, the State Tax Commissioner made adjustments downward on water-front property. Appeals were taken from the final determination of the State Tax Commissioner by the Debtor seeking a further reduction and by the City of Jersey City seeking to have the assessments increased. The State Board of Tax Appeals dismissed the Debtor's appeal and restored the assessments to the level of the 1938 assessments. The Trustees were notified of these decisions by letter dated June 15, 1942. Thereupon the Trustees obtained from the United States District Court an order upon the State taxing authorities and the Attorney-General to show cause why the judgment of the State Board of Tax Appeals should not be declared null and void. After hearing, the District Court entered Order No. 171, whereby it was determined that the Debtor's tax liability for 1939 had been definitely fixed by Order No. 163, which had in turn fixed the assessment for 1939 at the lower level. This order was reversed by the United States Circuit Court of Appeals in *In re Central Railroad Company of New Jersey*, 136 F. (2d) 633, 640. An application for a writ of certiorari from this Court was denied (320 U. S. 805).

The above covers all of the tax years prior to bankruptcy, including the year 1939, for which last-mentioned year the taxes did not become in default until December 1, 1939, over one month after bankruptcy.

B. *Concerning the Tax Settlement Acts litigation.*

Notwithstanding the termination of the litigation for the tax years 1932 to 1936, all adversely to the claims of the Debtor and other railroad companies by the judgment in the *Central Railroad* vs. *Martin*, 115 F. (2d) 968, *supra*, on November 27, 1940, large amounts of taxes for those years still remained unpaid in July, 1941. The Legislature of the State of New Jersey compelled by the concerted refusal of the railroad companies to pay millions of dollars in taxes

due and payable to the State of New Jersey, adopted Chapter 290 of the Laws of 1941, whereby it was sought to forgive the several railroad companies their obligation to pay back interest and to permit the payment of the principal amount of the taxes over a period of years plus 3% interest on the unpaid balance from December, 1940. This Act and Chapter 241 of the Laws of 1942, which is amendatory thereof, are designated as the "Tax Settlement Acts."

The 1941 Act provided in Sections 7 and 8, for the participation by the Attorney-General in the tax settlement scheme as follows:

> "7. Undertaking; first payment. Any railroad or system or the receiver, trustee or trustees thereof, may enter upon the execution of an installment payment plan authorized under this act by (1) duly executing and filing with the State Comptroller a written undertaking, in such form as the Attorney-General shall prescribe, for the payment of the total amount of delinquent taxes owed by the railroad or system and (2) paying into the State treasury an amount not less than the first annual installment together with interest on the unpaid balance computed in the manner provided by sections two, three and four of this act.
>
> "8. Waivers. The first payment tendered pursuant to this act shall be accompanied by a waiver of any and all rights to contest the legality or amount of any assessment made prior to December first, one thousand nine hundred and forty-one, together with stipulations, consents or other papers for the discontinuance and dismissal of all suits, actions, and proceedings pending in any court or before the Board of Tax Appeals concerning such assessments, all in such form as the Attorney-General may require."

The Attorney-General being of the mind that the Act was unconstitutional refused to give his consent and instead on September 4, 1941 (barely six weeks after the passage of the Act), filed an information in the Court of Chancery of New Jersey seeking a determination as to the constitutionality of the first Settlement Act.

The railroad companies seeking to obtain the benefits afforded by the said Act regardless of the refusal of the Attorney-General to participate in the settlement machinery, discontinued certain pending further appeals of their 1937 and 1938 taxes but not in the manner provided by the said Act. From the above statement concerning prior litigation, it can be seen that such discontinuance was a matter of form only as there was no meritorious questions left to be litigated since all questions had been held to have been made res judicata by *Central Railroad* vs. *Martin*, 115 F. (2d) 968, 973. As was said in *Wilentz* vs. *Hendrickson*, 135 N. J. Eq. 244, 260, with respect to any further litigation for such years:

> "• • • the asserted rights of the railroad taxpayers are 'illusory,' rather than real."

But of greater significance is the fact that there was no requirement for the several railroad companies to pursue the course which they did. A reading of the original Settlement Act discloses that there was no necessity of discontinuing the several suits in the manner chosen. It was only required that discontinuance documents be filed with the fiscal officers of the State in the form approved by the Attorney-General. Since he had refused to approve the form, no such documents could therefore have legally been received at that time. Thereafter, when the 1942 Amendment (P. L. 1942, Chapter 241) took effect the injunction of the Chancery Court immediately issued and the Treasurer again was powerless to accept the tender of such docu-

ments by reason of such injunction. (136 F. (2d) 633, 638.) Had the several railroad companies been of the notion that there was anything of merit left to litigate, they would have tendered the documents in the manner prescribed by the terms of the Settlement Acts, and then would have gone to the New Jersey courts and asked for leave to keep open their appeals pending the determination by the New Jersey courts of the question of constitutionality.

Notwithstanding that the several railroad companies did not seek to intervene in the tax settlement controversy and were not parties to such litigation, the record discloses that the matter was strongly litigated, the Attorney-General on the one hand urging the unconstitutionality of the Acts and the State Treasurer on the other, through eminent counsel, urging the constitutionality of such Acts. (133 N. J. Eq. 447; 135 N. J. Eq. 244.) Not only this but the Legislature of New Jersey sought to cure obvious constitutional deficiencies by the adoption of the amendatory act in May, 1942 (Chapter 241 of the Laws of 1942), during the pendency of such litigation.

On May 21, the very day the amendatory act was enacted into law, under which the participation of the Attorney-General was eliminated, an injunction issued out of the New Jersey Court of Chancery restraining the State fiscal officers from accepting any payment or otherwise performing the terms of the Settlement Acts. On July 20, 1943, the Court of Chancery determined the Settlement Acts to be unconstitutional (*Wilentz* vs. *Hendrickson*, 133 N. J. Eq. 447). The New Jersey Court of Errors and Appeals affirmed the decree of the Chancery Court on June 22, 1944. (135 N. J. Eq. 244.)

In the meantime and on June 2, 1942, the Trustees petitioned the District Court for instructions with reference to their compliance with the Settlement Acts. As a result of such petition, the Trustees were instructed and directed to comply with the said Settlement Acts and Order No. 163

was entered fixing the amount due to the State of New Jersey for taxes and interest at the amount that was provided by the terms of the said Settlement Acts. The State of New Jersey appealed to the United States Circuit Court of Appeals for the Third Circuit. On May 27, 1943, the said Court reversed the said Order No. 163 and held that the District Court in the exercise of a nice discretion should have withheld any determination as to the constitutionality of the Settlement Acts pending the determination of such question by the New Jersey Courts (136 F. (2d) 633). It is significant that the Circuit Court of Appeals made its determination prior to the judgment by the New Jersey Court of Chancery and in plenty of time for the Trustees to have applied to intervene in the New Jersey Settlement Acts litigation. A rehearing was denied on July 15, 1943, still prior to July 20, 1943, the date of the judgment by the Chancery Court. It should likewise be pointed out that the Trustees had more than one year from May 27, 1943, until June 22, 1944, when the Court of Errors and Appeals made its final determination, within which to intervene in the Settlement Acts' controversy.

The Trustees, by their petition of August 14, now seek to have the Bankruptcy Court make an adjudication that a binding contract exists with the State of New Jersey upon the basis of their abortive attempts to comply with the terms of the unconstitutional Settlement Acts. This contention was disposed of adversely to the Trustees in *In re Central Railroad Company of New Jersey*, 136 F. (2d) 633, 638, *supra*, wherein the Court said:

> "The final contention that the issue between the State and the Trustees is moot by reason of the tender to the Treasurer of a payment pursuant to Order No. 163 must also fail. The tender though acknowledged was not accepted by the Treasurer and consequently was without legal effect. In fact, the Treasurer was

powerless to accept the tender by reason of the injunction issued by the Court of Chancery."

Similar argument to that which is now advanced by the Trustees in connection with the present application was advanced before this Court in connection with an application for a writ of certiorari to review the judgment in the just mentioned case, which application was denied. (320 U. S. 805.)

C. *Concerning the litigation with respect to the August 14 petition.*

Approximately two months after the New Jersey Court of Errors and Appeals made its determination in *Wilentz vs. Hendrickson, supra,* the Trustees filed its petition of August 14, wherein the Trustees sought to have the Bankruptcy Court make certain determinations with respect to the taxes and interest due to the State of New Jersey, as more particularly set forth on page two above.

A reading of the petition of August 14, discloses that the Trustees still seek to have the Bankruptcy Court make a redetermination of the questions decided adversely to themselves in *In re Central Railroad Company of New Jersey,* 136 F. (2d) 633, *supra,* and to adjudicate concerning the constitutionality of a state law declared by the highest court of our State to be wholly unconstitutional. *Wilentz* vs. *Hendrickson,* 135 N. J. Eq. 244. Since this determination the Act has again been held inoperative in *State* vs. *Erie Railroad Co.,* 23 N. J. Misc. 203, in a suit by the State against five major railroad companies. It would seem that the Trustees had sought by the petition of August 14, also to have the Bankruptcy Court redetermine certain tax questions which had been said by the Federal Court to have been made res judicata by the New Jersey Supreme Court in *Central Railroad Company* vs. *Martin,* 114 N. J. L. 69,

supra (R. pg. 47), although they now disclaim any such intent. We are unable to determine whether the disclaimer is because of the action of the courts in the tax litigation or because of a purported compliance with the Settlement Acts. They have requested the Bankruptcy Court to make certain other adjudications but have not shown where the Bankruptcy Act has given jurisdiction to the Bankruptcy Court in such matters.

Since all of the taxes due to the State of New Jersey had become a lien paramount to all other liens upon the lands, tangible property and franchises in the State of New Jersey, not later than June 1, 1939, and over four months prior to October 30, 1939, when the petition for reorganization was filed, the State moved on special appearance to have the said petition of August 14 dismissed insofar as it sought to take jurisdiction for the purpose of making adjudications that would be binding upon the State of New Jersey with respect to the pre-existing tax liens of the said State. The argument of the State concerning the jurisdiction of the Bankruptcy Court was comprised within two broad classifications (1) Congress did not give power to the Bankruptcy Court to undertake the review sought by the Trustees in the instant case with respect to the State's tax liens affixed prior to bankruptcy; and (2) if Congress intended to grant such power, such grant of power is subject to the rule that the consent of the State must be obtained before such power may be exercised, otherwise the grant of power would be unconstitutional.

Over objection of the State, the District Court Judge referred the matter contained in the petition of August 14, including the jurisdictional questions, to the Standing Master for determination and report. The Standing Master made a finding that the Bankruptcy Court did have jurisdiction to entertain the several matters contained in the said petition. Again, over objection of the State, the

District Court Judge confirmed the report of the Standing Master by its Order No. 271.

Believing that neither the Standing Master nor the United States District Judge had fairly met the objection of the State with respect to its claim that the tax liens of the State of New Jersey affixed at the time of bankruptcy were not within the jurisdiction of the Bankruptcy Court, the State petitioned the United States Circuit Court of Appeals for a Writ of Prohibition forbidding and preventing the Court from adjudicating concerning the said tax liens. The efforts of the State to have the jurisdictional question answered are set out in detail in the petition for said writ, set forth at length at page 10 of the *Record and more particularly* from pages 14 through 18. The Circuit Court of Appeals allowed its rule to show cause why the said writ should not issue. Thereafter, the said Court called a conference of counsel representing the respective parties and suggested that the matters contained in the appeal from Order No. 271 and the application for the Writ of Prohibition be consolidated to the end that the specific jurisdictional question with respect to the State's tax liens should be determined. This was done and the Court had before it, when it made its decision, all matters having to do with the appeal from Order No. 271 and the request for the Writ of Prohibition.

The Court below, in reversing Order No. 271, held that it was not necessary to answer the jurisdictional objections set forth in the two broad classifications above because the jurisdiction of the Bankruptcy Court was limited in the manner set forth in *Arkansas Corporation Commission* vs. *Thompson*, 313 U. S. 132 (1941). The Court held, in effect, that even if there be jurisdiction, yet, under the facts of the instant case, such jurisdiction is limited to a determination of whether there was mathematical error in computation, saying (R. pg. 167) that:

"Failure of this opinion to touch upon certain points raised by the State of New Jersey is not to be construed as meaning that they are without merit; rather, our decision renders discussion of them unnecessary."

The Court thereupon reversed Order No. 271 with costs to the State and stated that, since this disposed of the entire matter before them, the application for the Writ of Prohibition should be dismissed without costs to either party. It is clear that the Court determined that all jurisdictional questions had been fully determined and that it was, therefore, unnecessary to consider the issues urged and presented by the State in its application for a Writ of Prohibition.

D. *Concerning matters that have arisen in the Section 77 proceedings.*

The Debtor filed its petition under Section 77 on October 30, 1939. This was done, as stated above, because the Attorney-General was proceeding to perform his statutory duty under New Jersey Revised Statutes 54:28–1, which required that, if a tax shall remain unpaid in whole or in part for ten days after the expiration of the time limited for the payment thereof, the Attorney-General "*shall apply forthwith*" for entry of judgment (App. pg. 136) and by R.S. 54:28–2, wherein it is provided that the Attorney-General "shall apply for an order that execution forthwith issue on the judgment" (App. pg. 137). On November 1, 1939, the Court issued its injunction restraining the said Attorney-General from proceeding to enforce the lien for its 1932 and 1933 taxes in the manner required by law (R. pg. 195).

Subsequent to the institution of the Section 77 proceedings and on November 27, 1940, the Circuit Court of Appeals rendered its decision with respect to the 1934, 1935 and 1936 taxes of the Debtor (115 F. (2d) 968). Thereafter

and on December 15, 1940, the Comptroller filed a proof of claim upon a form submitted by the Trustees as shown on page 64 of the record. On February 27, 1941, the Trustees filed objections to the proof of claim covering all the years 1932 to 1939, notwithstanding that the Circuit Court of Appeals had specifically decided adversely to themselves all questions concerning the 1932 to 1936 taxes and by necessary inference all questions with reference to all the other years. The Trustees in their petition for adjudication of August 14 failed to call to the attention of the Court the reply of the State of New Jersey to the said objections. In that reply (R. pg. 245, par. 12) the following will be found:

> "12. This court has no jurisdiction, power or authority to make a new assessment or tax levy, or to revise or reduce the amount of the assessments or taxes, or any of them, or to abate or reduce the amount of the legal interest which has accrued, or which may hereafter accrue, to date of final payment, upon the amount of taxes in default on any due date, as prescribed by the railroad tax acts of the State of New Jersey.
>
> "Wherefore Claimant prays for the dismissal of said objections, and each of them, and for allowanee of the full amount of each of said claims and interest as set forth in Schedule 'A' attached thereto, respectively, together with interest on said taxes, respectively, at the rate of 1% per month and after December 1st, 1940."

It is obvious from a reading of the record that no responsible official of the State of New Jersey had considered that it was submitting any question concerning the amount due to the State of New Jersey to the Bankruptcy Court. No reasonable person could have felt otherwise than that, when the Circuit Court of Appeals had made its determina-

tion with respect to the 1934, 1935 and 1936 cases, reiterating what had been said with respect to the 1932 and 1933 cases, as reported in *Lehigh Valley Railroad Co.* vs. *Martin*, 100 F. (2d) 139, *supra*, just one year earlier, the only thing left open to the railroad was when it would pay its bill. That apparently was the attitude of the fiscal officials charged with responsibility in such matters.

The Trustee now contends in its brief (pg. 87) that the State has been urging an enlargement of its lien under the new Railroad Tax Act. The Trustee is unable to show one single instance where the State has been insisting that it has a lien other than upon the lands, tangible personalty and franchises of the Debtor.

The Legislature in 1941 sought to ease the tax burden of the several railroad companies by providing a 3% property tax rate in lieu of much higher average rates and local rates in existence under the old law and to supplement this with a franchise excise tax based upon net operating income (Chapter 291 of the Laws of 1941). That the new law does, in fact, effect a very substantial saving to the Central Railroad Company is borne out by the case of *Jersey City* vs. *State Board of Tax Appeals*, 133 N. J. L. 202, wherein because of the reduction in taxes for the year 1941 to the several railroad companies, including this Debtor, the Act was declared to be unconstitutional with respect to that year only. This judgment was reversed by the Court of Errors and Appeals in *Jersey City* vs. *Kelly*, 134 N. J. L. 239. The additional cost to the Trustee for 1941 taxes alone would have been in excess of one million dollars. (App. pg. 152.)

We point this out to show that any complaints that the Debtor may now have with respect to assessments under the new Act come in ill grace considering that the legislation was adopted for the purpose of helping the several railroads which had been complaining of the tax burden during times of poor earnings. Because of the new fea-

tures of the Act, which no longer provided for a property tax upon franchises, it became necessary to change the terminology of the Act. However, it is clear from Section 54:29a–74 of the Act that the Legislature never contemplated that there would be any lapse such as is suggested in the argument of the Trustee. By the just-mentioned section, it is provided:

> "This act shall be construed as a revision of chapters nineteen through twenty-nine, inclusive, of Title 54 of the Revised Statutes, and nothing herein shall be construed to affect any pending litigation, nor to repeal, abate, cancel, cause to lapse or otherwise affect in any manner any assessment or the lien or obligation to pay any taxes heretofore assessed to any taxpayer, or the legal authority to collect taxes, interest and penalties which have accrued under any provision of law repealed by this act or under any other law, except as specifically provided in this act * * *."

The Trustees in their brief (pg. 81) claim that the State in accepting some $18,000,000, during the pendency of these proceedings has consented to the jurisdiction of the Court. With respect to the 1939 taxes, these did not become due and payable and in default until December 1, 1939, so that under the rule of *Reconstruction Finance Corporation* vs. *Missouri, Kansas and Texas R. Co.*, 122 F. (2d) 326, C. C. A. 8th 1941, and *Boteler* vs. *Ingels*, 308 U. S. 57 (1939), these quite properly could be treated as a charge against the administration. As for the 1940 taxes, which became due and payable on December 1, 1940, there can be no question but that they were and are an administration charge, which under the law the Trustees were required to pay. The acceptance of current taxes could by no stretch of the imagination be a submission to jurisdiction.

With respect to the payment made this year subsequent to the filing of the petition for certiorari in this cause, we have stated our position above (pg. 5). This payment was made for the sole purpose of stopping the running of interest after the Court had before it testimony to show that the property of the Debtor was worth far in excess of the State's tax liens. The State accepted this sum with the assurance of the United States District Court and the several parties that all questions with reference to jurisdiction remained open as heretofore and that by such acceptance the State was waiving none of its jurisdictional objections.

This leaves open only the payments made with respect to the 1932 and 1933 taxes. Such payments were made after this Court had refused certiorari. The said payments totaling less than $1,000,000 could quite properly be made by the Trustees in order to save the running of interest upon a portion of such amount. The Trustees have not shown where they have been in any wise hurt by such payment and the saving of interest of a substantial portion of such amount clearly warranted the payment by the Trustees. It can hardly be said that the request by the Attorney-General of a sum finally and definitely fixed after extensive litigation and which occasioned the filing of the Section 77 proceedings could be a recognition of jurisdiction with respect to the State's tax liens, particularly since the Attorney-General was enjoined from proceeding with his mandatory duty of enforcing the State's tax liens in the New Jersey Courts, the only Courts open to him by law. *Great Northern Life Insurance Co.* vs. *Read*, 322 U. S. 47. (1944.)

E. *Concerning the application for a Writ of Prohibition.*

Again referring to the application for the writ of prohibition, when the Standing Master made his Interim Report and stated that the Bankruptcy Court has power to determine the amount and validity of the State tax claims

and "the incidental liens alleged to affect the property in the custody of the Court," the State applied to the Circuit Court of Appeals for the said writ to restrain the Bankruptcy Court from undertaking any consideration of the tax liens of the State existing at the time of bankruptcy. The State did this advisedly because of the distinction between pre-existing liens, inchoate statutory liens and unsecured claims. The State has freely admitted that, in an ordinary bankruptcy proceeding, if the Bankruptcy Court first receives the property free of lien, it is incumbent upon the lien-holder to come into the Court in order to establish that lien. By N. J. R. S. 54:28-5 it is provided that on property other than that used for railroad purposes, the State liens do not attach until after the judgment is entered, the same as in the case of any other judgment. If we were now asserting a right to a lien under such section and this were a regular bankruptcy, we would be in the position of an applicant and subject to the bankruptcy act.

Because there was the possibility that, when the case came before an appellate court, the said case might go off on the narrow question of whether or not the Court had the right to determine the amount due upon any claim which we might have to make by reason of such inchoate statutory liens or by reason of a claim against unencumbered assets in the event of deficit, we filed the said Application for a Writ of Prohibition. The petition for such Writ is set forth on pages 10 to 21 of the Record.

The Circuit Court of Appeals, when the matter became ready for argument, called a pre-argument conference at Philadelphia. At that conference the Court suggested that the appeal from Order No. 271 and the Application for a Writ of Prohibition should be argued together to the end that the jurisdictional question in which the State is primarily interested—whether a State with pre-existing tax liens may be compelled against its will to participate in a plan of reorganization or otherwise lose its liens and

whether such pre-existing liens may be made the subject of litigation without such State's consent—might be fairly argued and determined.

The Court in reversing the said Order No. 271 said that it was unnecessary to determine the matters contained in the said petition for the Writ of Prohibition. We respectfully submit that the matter is now before this Court in such manner that the broad jurisdictional question advanced by the State concerning its pre-existing lien may be finally determined. We are in no wise concerned here with the question of the power of the Bankruptcy Court to adjudicate concerning any claim the State might have to make against unencumbered assets in the event of a deficit nor with the assertion of an inchoate statutory lien as provided in R. S. 54:28–5 in the event the State's paramount lien upon the property in railroad use is insufficient to liquidate the tax debt.

SUMMARY OF ARGUMENT.

1. Congress did not intend to include a State having tax liens affixed at the time of the filing of a Section 77 petition as a creditor or claimant in a Section 77 proceeding so that such State could without its consent be made to participate in a plan of reorganization under such section.

2. Congress did not authorize the Bankruptcy Court summarily to adjudicate concerning a State's lien for taxes affixed at the time of the institution of Section 77 proceeding without its consent and such power is not granted by Section 77, Section 64, Section 57 or Section 67 of the Bankruptcy Act.

3. If Congress did intend to grant power to the Bankruptcy Court to compel a State having pre-existing tax liens to participate in a plan of reorganization or to adjudicate summarily concerning saids pre-existing tax liens, such grant of power must be subject to the State's consent otherwise such grant of power is unconstitutional.

4. The State of New Jersey has not authorized any State officer nor is there any statutory authorization showing that the State has consented to participation in a plan of reorganization or has submitted its pre-existing tax liens to the jurisdiction of the Bankruptcy Court.

5. Notwithstanding that Section 64 or any other provision of the Bankruptcy Act may be held to be applicable in Section 77 proceeding, under the rule established by *Arkansas Corporation Commission* vs. *Thompson*, 313 U. S. 132 (1941), the Bankruptcy Court was not authorized to undertake jurisdiction under the facts of the given case.

6. The petitioner has shown no authority for the Bankruptcy Court summarily to adjudicate the several questions presented by the petitioner with respect to the applicability of the so-called Settlement Acts, and no such authority exists either pursuant to State or Federal law.

7. The petitioner has stated that it is "crystal clear" that said petitioner is not questioning the amount and validity of taxes. It necessarily shows that the only matter left for consideration is the constitutionality or applicability of the so-called Settlement Acts. This involves a question of State law. Particularly in view of the fact that the Circuit Court of Appeals has already said that an exercise of nice discretion requires withholding determination on such matters pending the determinations of the New Jersey Courts, it is even more important that, in the exercise of such nice discretion, the Bankruptcy Court should not now entertain the present petition but should refer the whole matter to the State Courts for determination of any State questions still unanswered.

ARGUMENT.

POINT I.

The petitioner has misconceived what constitutes "the estate of a bankrupt in custodia legis" and on the basis of such misconception has confused the several jurisdictional issues.

This point is presented by way of introduction to our argument. We hope thereby so to channelize such argument that the confusion and misunderstanding of same so manifest in the briefs of our opponents here and below may be eliminated or at least minimized.

The fundamental question is of course—Did Congress intend to grant power to the Bankruptcy Court summarily to adjudicate in Section 77 proceedings concerning a State's tax liens affixed at the time of bankruptcy without the State's consent? The answer to that question requires the consideration of several other questions, all advanced by the State below to prove that Congress did not intend to and could not, if it would, grant the power to the Bankruptcy Court to make such adjudications. Several distinct jurisdictional objections have been urged. Neither the petitioner nor the bondholders have answered those objections. They have cited cases indiscriminately concerning jurisdiction in refutation of our argument, although the point involved in a cited case has been freely admitted by us and the said case immaterial to the issue before this Court. This situation has come about because of the failure of our opponents to channelize their argument so as to meet forthrightly each separate jurisdictional question.

With what does Congress deal under the bankruptcy clause of the federal Constitution? In *Kothe* vs. *R. C. Taylor Trust* 280 U. S. 224, 227 (1930), this Court said:

> "The broad purpose of the Bankruptcy Act is to bring about an equitable distribution of the bank-

rupt's estate among creditors holding just demands based upon adequate consideration."

As was said by the Court in *In re Swofford Bros.*, 118 Fed. 549, 556 (D. C. Mis. 1910):

> "It must be remembered that the policy and purpose of all national bankruptcy acts is primarily to secure an equal and speedy distribution of the property of the bankrupt among his creditors. A further object is to relieve the honest debtor from legal proceedings for his debts, and to enable him to have a fresh start in business life; but the distribution of the property is the principal object to be attained—the discharge of the debtor is incidental and subordinate."

Merchants' National Bank 228 U. S. 634 (1913); *Clarke* vs. *Rogers* 228 U. S. 534 (1913), and many other cases support this view.

Ours has not been a static law but a flexible and pliable instrument fully capable of meeting expanding and changing economic and social conditions. In commerce we have had within a few short years the stage coach and covered wagon, the railroad, motor transport and now air transport. And our concept of commerce law has kept pace with such changes and expansion. But always any change in interpretation has been securely anchored to the basic principle of commerce.

And so, in bankruptcy, we have likewise had an expanding and changing concept of the law. Thus in the beginning, the bankruptcy laws were limited to traders and involuntary proceedings. Then were added other persons and voluntary proceedings became lawful. In turn we have seen proceedings for reorganization of railroad companies and other corporations and most recently the expansion of the bankruptcy power to include readjustment of municipal obligations providing there be consent. In all of this ex-

pansion and change, however, Congress has dealt with the affairs of an embarrassed Debtor or bankrupt. The primary purposes of legislation have been with respect to the affairs of a person who cannot meet his or its obligations ex contractu or ex delictu.

With this changing and expanding concept, we have no quarrel just so long as any change deals only with that with which Congress has authority to deal—the estate of the Debtor or bankrupt who cannot meet his obligations. But what is that estate?

We urged below and we again urge that considerable confusion will be caused unless we thoroughly understand what is meant by the term "the estate in custodia legis," and unless we differentiate between (a) the question of jurisdiction over the "estate in custodia legis"; (b) the question of the grant of power to adjudicate concerning pre-existing encumbrances upon an "estate in custodia legis"; and (c) the wholly different question of the power to exercise such jurisdiction in a given case. Proper consideration of the main question thus requires a progressive approach, each step in the progression being carefully shielded if possible from contact with the several other steps in order to avoid the above-mentioned confusion.

A. *Concerning "the estate in custodia legis."*

It has been held repeatedly that the Bankruptcy Court has exclusive jurisdiction of the "estate in custodia legis." But, what is the "estate in custodia legis" at the inception of bankruptcy? Is it the property free and clear of all encumbrances, making it incumbent upon every lienor and every mortgagee to come into the Bankruptcy Court in every bankruptcy to establish his lien or mortgage notwithstanding that prior to the bankruptcy the bankrupt's property was subject to such lien or mortgage? Or is such "estate" the property of the bankrupt subject to such lien or mortgage making it necessary for the bankrupt's trustee to be the moving party in case of controversy?

It is fundamental that a trustee in bankruptcy takes custody of the property of a bankrupt in the same "plight and condition" in which the bankrupt himself held such property at the time of bankruptcy. *Thompson* vs. *Fairbank*, 196 U. S. 516, 526 (1905). A trustee takes any property of a bankrupt subject to whatever liens existed as against the bankrupt. *Rode & Horn* vs. *Phipps*, 195 F. 414 (C. C. A. 6th, 1912). And this is not a modern rule but is a rule of ancient vintage. In Blackstone's Commentaries, Book II, pg. 286, it is stated that the commissioners of a bankrupt took only the equity of redemption in a mortgaged estate. *First National Bank* vs. *Staake*, 202 U. S. 141 (1906) cited by Petitioner does not state a different rule. This Court in that case distinguished the facts but reaffirmed the general rule at page 149.

In *Marshall* vs. *New York*, 254 U. S. 380, 385, this Court said:

> "• • • a receiver appointed by a federal court takes property subject to all liens, priorities or privileges existing or accruing under the laws of the State • • •"

To the same effect is *Atchison, T. & S. F. R. Co.* vs. *Hurley*, 153 Fed. 503 (C. C. A. 8th 1907) aff'd, 213 U. S. 126, citing *Hewitt* vs. *Berlin Machine Works*, 194 U. S. 296, *Thompson* vs. *Fairbank*, supra, *Humphreys* vs. *Tatman*, 198 U. S. 91.

The rule could not be otherwise in view of the history of bankruptcy and the broad purpose of the Bankruptcy Act, as stated by this Court in *Kothe* vs. *R. C. Taylor Trust*, *supra*.

The estate of this Debtor on October 30, 1939, was that which the Debtor actually owned on such date—the Debtor's equity in the properties to which it had title and which it operated. The legal situation is well explained in *In re Tresslar*, 20 F. (2d) 663, 664. (D. C. Ala. 1927.)

"As a proposition of law, I think that a valid lien, whether created by contract or by statute, upon the goods, wares, and merchandise in the hands of the trustees, reduces the estate of the bankrupt to the extent of the amount of the debt secured by the lien. The priority provided in subsection 6 of Section 64 of the Bankruptcy Act does not interfere with the disposition of money or property that does not belong to the bankrupt's estate. It simply directs the administration of the money belonging to the bankrupt's estate, and nothing more. It is the estate of the bankrupt which is administered, and what constitutes the estate is governed by the laws of the state."

Nothing in Section 77 discloses that Congress intended therwise. It is provided by Section 77 (U. S. C. A. 205) (c) (2) that:

"Prior to the appointment of a trustee, the debtor on behalf of the court shall continue in the possession of the property and shall operate the business thereof during such period, and shall have all the title to the property and shall exercise all power consistent with the provision of this section subject at all times to the control of the judge and to such limitations, restrictions, terms, and conditions as he may from time to time impose and prescribe."

It is inconceivable that Congress intended that the Debtor should on October 29 have a title subject to tax liens, mortgages and other liens and by the simple expedient of the filing of a petition under Section 77 enlarge that estate so that the said Debtor would now have an unencumbered title. In *Continental Bank* vs. *Rock Island*, 294 U. S. 648, 676 (1935), the Court said:

"The injunction here in no way impairs the lien, disturbs the preferred rank of the pledges. It does no more than suspend the enforcement of the lien by a sale of the collateral pending further action."

In the just mentioned case, the bank had possession. In ours, the trustee had possession. But there can be no sound basis for distinguishing between the quality of the estate in the two cases. The Debtor continued its possession of just exactly what it had just prior to bankruptcy and handed over to the trustees just that and nothing more.

We may have appeared to have labored this point in view of the statement of the special master on page 16 of his interim report (R. pg. 39), to the effect that the property is in custodia legis subject to the rights of lien-holders. But the master pays only lip service to the rule and then goes on to treat such liens as incidental to demands that he assumes must be made to the trustee in order to establish the right of the State to such lien amounts. The two positions are irreconcilable. The latter position can only be justified on the theory that the trustee in bankruptcy takes the property of a Debtor in the first instance, free and clear of all liens and other encumbrances and that it is incumbent upon lienors, including a sovereign State having liens for taxes affixed at the time of bankruptcy, to establish their rights to their liens in and to such property before the Bankruptcy Court.

This position is not novel, and was passed upon by this Court in *York Mfg. Co.* vs. *Cassell*, 201 U. S. 344, wherein a ruling of the Circuit Court of Appeals that a seizure by the Bankruptcy Court operated as an attachment and an injunction for the benefit of all persons having an interest in the property was reversed. See also *In re Plattville Foundry and Machine Co.*, 147 F. 829 (D. C. Wisc. 1906), where it was said:

"This would seem to follow, indeed, from the rules laid down by the Supreme Court of the United States to the effect that the trustee takes no title to the interest of the lien claimant."

The Special Master overlooked the cases which hold that one having security for his debt may not prove his claim against the estate unless he surrenders his security or first exhausts his security and makes claim for only the resulting deficit. *New York Trust Co.* vs. *Palmer*, 101 F. (2d) 1 (C. C. A. (2d) 1939); *In re Hagin*, 21 F. (2d) 434 (D. C. La. 1927), aff. 33 F. (2d) 563. Regardless of the argument of this petitioner, we do not believe it can successfully be urged that any officer of the State of New Jersey was given the authority to surrender the security which the State has for its tax debt in the instant case and to prove as an unsecured creditor under Section 64 a.

In conclusion of this subpoint, we respectfully urge that the Trustees took title and possession of certain properties used for railroad purposes by the debtor in the State of New Jersey but that such title was and is subject to the State liens for taxes for the years 1932 to 1939, the latest having attached five months prior to bankruptcy. The estate of the debtor was subject to such liens just prior to bankruptcy and the "estate in custodia legis" is the self-same estate.

B. *Concerning jurisdiction of "the estate in custodia legis."*

The State has freely admitted that the Trustee has title to and possession of the property used by the Debtor for railroad purposes in the said State, and that the Bankruptcy Court may do anything necessary to protect that possession and maintain the status quo. Our discussion of the jurisdictional question will be better understood if we state our understanding concerning the assets of a bankrupt.

There are three broad phases or classifications involved in our discussion. *First.* A bankrupt may have unencumbered assets or valuable equities in encumbered assets. By the mere institution of bankruptcy proceedings, such assets are taken into the custody of the Bankruptcy Court and jurisdiction is given to the Court to distribute the sums realized upon such assets to the several creditors pursuant to Section 64. Any claimant, including a State, desiring to participate, must submit to the jurisdiction of the Court. *New York* vs. *Irving Trust Co.*, 288 U. S. 329 (1933), and *Lyford* vs. *City of New York*, 137 F. (2d) 782 (C. C. A. 2nd 1933) are authority only for such rule. *Second.* A bankrupt may have property which is still free of any lien, but against which a State has the right to claim a lien. We have such right in the instant case upon other than property in railroad use. (N. J. R. S. 54:28–5.) In such a case, the Court in the first instance receives the property free of the lien and so obtains jurisdiction of the subject matter of the inchoate lien. In an ordinary bankruptcy proceedings, the Court would have custody of the res and it would be incumbent for a State to assert its right to a lien or take the chance of having its right lost. *Van Huffel* vs. *Harkelrode*, 284 U. S. 225 (1931); *Straton* vs. *New*, 283 U. S. 318 (1931), and *Lyford* vs. *State of New York*, 140 F. (2d) 840 (C. C. A. 2nd 1944) are simply authority for this rule. *Third.* A bankrupt may have property already subject to existing liens. In such a case the Bankruptcy Court takes custody of the property subject to such existing liens and before any binding adjudications may be made concerning such liens the lien-holder must be made a party to the proceedings. In the first two examples the Court operates against the res. In the third, the action must of necessity in the first instance be in personam and subject to the necessity of due process. We are in the third class.

The Bankruptcy Court is fully empowered at all times to protect the equity in the "Third" example. No matter how

valueless the Debtor's interest in a given property may appear to be, the Court, nevertheless, has the power to prevent interference with that interest. But the Court does not operate upon the premise that the said property is unencumbered property. It directs its action upon the equity of the Debtor in such property. As we have said, the purpose is to maintain the status quo, to preserve all equities until such time as it may be determined whether reorganization can be effected and whether a given property or undertaking is essential to such reorganization. *Continental Bank* vs. *Rock Island R. Co., supra; Smith* vs. *Hoboken R. R. Co.*, 66 S. Ct. 947; *Thompson* vs. *Texas Mexican R. Co.*, 66 S. Ct. 937. (1946.)

In the meantime and pending such determination, the State may dispose of its interest or do anything else short of foreclosing its lien. On its part, the Debtor may dispose of a given property subject to the State's lien. In short, anything may be done by either that does not affect the said status quo. Of course, the State may be damaged by the exercise of such power by the Trustee but in such case there would be presented a situation where the interest of the State would have to give way to the paramount right of the Federal Government. It is not denied, that as long as the Bankruptcy Court is acting properly to protect the equity of the Debtor in the said property, it is acting within the limits of the bankruptcy power and the right of the State to enforce its lien for taxes is subordinate to that power. It is our purpose to show that as long as the State is willing to await the outcome of such determination and does not press enforcement in the Bankruptcy Court, the State can not be made to come into a Section 77 proceedings without its consent.

When the Bankruptcy Court made its order No. 3 whereby, on November 1, 1939 (R. pg. 195), the Bankruptcy Court enjoined the Attorney-General from proceeding with the collection of the 1932 and 1933 taxes as out-

lined above (pg. 17), the State took no appeal. It admitted and admits jurisdiction to that extent. Since we have never denied jurisdiction in such a case, *In re Tyler*, 149 U. S. 164 (1893), *Ex parte Baldwin*, 291 U. S. 610 (1934), and other similar cases, throw absolutely no light on the jurisdictional issues, as we understand such issues, but instead tend only to confuse such issues.

In conclusion of the subpoint we submit that in the present discussion we are not at all concerned with the extent of power of the Bankruptcy Court with respect to the equity of the Debtor in the certain properties. With respect to that, the Bankruptcy Court's power is broad and comprehensive. As we stated above at page 23, we are not concerned with any eventual claim for a deficit against unencumbered assets, nor are we concerned with the perfecting of an inchoate statutory lien under R. S. 54:28-5. We are concerned only with pre-existing statutory liens for State taxes and the extent of jurisdiction concerning such pre-existing liens.

C. *Concerning the jurisdictional questions which are vital to the issues of our case.*

What then are the real jurisdictional questions involved? Again we are confronted not with a single question but a series of questions pertinent to the fundamental issue of jurisdiction presented by the facts of the instant case. Those questions are comprised within two broad categories: (1) jurisdiction of subject matter and (2) the power to exercise jurisdiction in a given case, involving the subject of process. Again consideration of the two categories must be kept separate and distinct unless we would fall into confusion. Clarity demands that cases be not indiscriminately cited as authority for the combined powers when it must be apparent that grant of power and the exercise of power in a given case are separate and distinct things. Obviously

if Congress did not intend to include a State's tax lien within the grant of power to the Bankruptcy Court in Section 77 proceedings, we are in no ways concerned with those cases dealing with the exercise of power in a given situation nor are we concerned with the question of the State's consent. And so we are first concerned with the distinction between an absolute want of power and the exercise of a granted power. *In re Tyler, supra* (pg. 181); *In re Sawyer*, 124 U. S. 200, 221 (1888).

(1) *Concerning jurisdiction of subject matter.*

As we undertake consideration of the jurisdictional questions actually involved, the first important question to answer is—Did Congress intend to include a State having liens for taxes at the time of bankruptcy within the meaning of the term "creditor" as used in Section 77? There is nothing involved and intricate or new and startling in this question. Just what did Congress intend? Mr. Justice Frankfurter said for this Court in *Palmer* vs. *Massachusetts*, 308 U. S. 79, 83:

> "Plainly enough the District Court had no power to deal with a matter in the keeping of state authorities unless Congress gave it. And so we have one of those problems in the reading of a statute wherein meaning is sought to be derived not from specific language but by fashioning a mosaic of significance out of the innuendoes of disjointed bits of statute. At best this is subtle business, calling for great wariness lest what professes to be mere rendering becomes creation and attempted interpretation of legislation becomes legislation itself. Especially is wariness enjoined when the problem of construction implicates one of the recurring phases of our federalism and involves striking a balance between national and state authority in one of the most sensitive areas of government."

Certainly no more important matter could be conceived than the necessity for a sovereign State to protect its taxes. *McCulloch* vs. *Maryland* 4 Wheat. 316. It would therefore appear that it is the duty of the petitioner to prove that Congress did intend to grant such power otherwise their case must fall at the very beginning.

We have therefore in Point III treated of the question of Congressional intent in the adoption of Section 77 of the Bankruptcy Act. We have scrupulously avoided any consideration of the question of the exercise of jurisdiction and the question of whether the State has given its consent for the reason that, if Congress did not intend to grant the power, such questions are irrelevant to the issue. In that connection we point out that, notwithstanding the tremendous volume of reorganization litigation under Section 77, not one single case has been presented where a State having liens for its taxes prior to bankruptcy has been made a party to a reorganization plan and been compelled to take either stocks or bonds in lieu of cash for its tax liens. Nor do we believe a case has been offered where a State or municipal taxing authority has been compelled to participate in a plan of reorganization without its consent.

We have therefore urged in Point III that Section 77 applies only to contract rights and is not at all concerned with rights acquired by a State prior to bankruptcy, incident to the essential governmental function of taxation.

We believe that, since Congress did not contemplate a State's participation in a plan of reorganization under the circumstances of the instant case, by the same token it could not have intended that certain other sections of the Bankruptcy Act should be applicable under such circumstances. We believe that the applicability of such other sections is limited to those persons only whose rights were intended to be affected by the said Section 77. While this Court refused to pass upon the applicability of Section 64 in *Arkansas Corporation Commission* vs. *Thompson, supra,*

and while the petitioner and bondholders seem now to be less sure of the applicability of such section under the facts of the instant case, the question of applicability must be determined in connection with the question of the intent of Congress with respect to the extent of the power granted to the Bankruptcy Court. Therefore in Point IV, we shall attempt to show that Congress did not intend that Section 64 should be applicable under the facts of our case and in Point V we shall show the lack of intent to have Sections 57 and 67 applicable.

(2) *Concerning the exercise of a granted power.*

If it is determined that Congress did intend to include a State having liens for its taxes affixed at the time of bankruptcy within the grant of power to the Bankruptcy Court in Section 77 proceedings, then we find ourselves confronted with two broad questions concerning the exercise of such power; (a) Was the grant of power without regard to consent, making it incumbent upon the State of New Jersey to participate in the reorganization proceedings in the manner prescribed by Section 77 or else be forever barred of its liens and its taxes?, or (b) Did Congress intend to grant such power subject to the rule that a State may only be a party if it shall consent? (Just as Congress specifically required consent concerning the claims of the United States for debts and taxes.) (Sect. 77(e).) (11 U.S.C.A. 205(e).)

(a) *As to the intent of Congress concerning consent.*

If it should be determined that Congress did intend to grant the power regardless of consent then we do not have to consider the question of whether the State has consented for such issue would be immaterial. The sole question then would be whether Congress could constitutionally grant such power—whether such grant of power concerning a matter of such purely local concern as property taxation would not be unconstitutional.

Again it is urged that we must carefully differentiate between the question whether Congress intended there to be consent and the question whether the State did in fact consent. In Point VI we have dealt with the question of the amount of power granted to the Bankruptcy Court in the event of the Court's holding that Section 77 proceedings contemplates a State's tax liens affixed at the time of bankruptcy. We will urge that, if Congress contemplated a grant of power in such a case, such grant must be subject to that State's consent otherwise the grant of power would be unconstitutional.

To appreciate the legal principles involved we must, at this stage of our scrutiny, again carefully avoid any consideration of acts of State officers alleged to constitute consent. We are concerned only with the question how did Congress intend that the Bankruptcy Court should exercise the power—regardless of consent or with the consent of a sovereign State? The Petitioner has failed to meet this issue and has so mingled the matter of consent and the matter of claimed grant of power that it is difficult to determine just what his real position is.

Only if it shall be determined that Congress did grant the claimed power and did grant such power subject to the State's consent, do we become concerned with the acts of the Comptroller and Attorney-General. In Point VI therefore we have sought to show that, even if Congress did intend to include a State's pre-existing tax liens in Section 77 proceedings, there could not constitutionally be the claimed grant of power except subject to the State's consent.

(b) *Concerning the facts alleged to constitute consent.*

If it is held that Congress did intend to grant power to the Bankruptcy Court to adjudicate concerning a State's liens for taxes affixed at the time of bankruptcy and if it is likewise held that such grant is subject to the State's con-

sent, then and then only need we consider the facts alleged by the petitioner to constitute consent. To maintain the distinction, we should direct all our jurisdictional study in the foregoing paragraphs to the date of the commencement of the Section 77 proceedings and before any action could possibly have been taken by the State officers. What was the situation then? We would then ask ourselves what has changed the situation?

In considering the factual matters alleged to constitute consent we thus do so under the circumstances that the Court does not have jurisdiction over the lien interest of the State prior to the doing of the acts alleged to constitute consent and under the circumstances that no step is necessary on the part of the responsible officials in order to preserve the said lien interest of the State.

We repeat that it is true that we can be prevented from enforcing the State's lien, and that in the interim values may tumble. But, we still retain our lien upon the properties. *Continental Illinois Bank* vs. *Rock Island Ry. Co., supra.* It is one thing to prove that a State's fiscal officer had consented for the State where the State is compelled to be a party regardless of consent. In that case consent is wholly illusory. It is compulsion. It is a wholly different thing to read consent into a situation by reason of conduct of State officers on the score of their alleged protection of interests requiring no protection. Concerning such interests, specific power must be found in the law before any action may be taken. *Newark* vs. *Civil Service Commission,* 115 N. J. L. 26, 29.

In this connection, both the petitioner and bondholders have failed to recognize the distinction between liens affixed at time of bankruptcy and unsecured claims. The distinction has been explained above. In the case of pre-existing liens the Court, if there is a requirement of consent and such consent is withheld, may only dispose of the security subject to the State's liens. If the State does

nothing whatever, the security will remain and the State must simply bide its time to enforce its liens.

In the case of unsecured claims, such as in *New Jersey* vs. *Anderson*, 203 U. S. 483, the State is in a different position. It cannot be made to come in and prove its claim. In a given case, the State might even prefer to avail itself of Section 17 (U. S. C. A. Sect. 35) having to do with the nondischargeability of State taxes. If, however, the State does not come in, it would lose a chance to share in those particular assets available for general creditors. If it does come in, it must submit to the jurisdiction of the Court. It cannot with one breath ask for a priority in the said general assets and with the same breath deny jurisdiction. But when it does come in, the limit of the jurisdiction of the Court is with respect to the distribution of such general assets. *In re Brannon*, 62 F. (2d) 959; *Henderson County* vs. *Wilkins*, 43 F. (2d) 670, 672 (C. C. A. 4th 1930).

If therefore a State having liens affixed at the time of bankruptcy may not be made a party without its consent and the limit of the power in the absence of consent is to maintain the status quo pending the determination of the possibility of reorganization, then specific statutory authority must be found authorizing the State's fiscal officers to submit the State's lien interest to the jurisdiction of the Bankruptcy Court. In the absence of a showing of such authority, the limit of the authority of such officers in the event Section 64 is applicable to Section 77 proceedings would be with respect to the making of a claim against unencumbered assets available for distribution to general creditors in the event that it should develop that the security together with those amounts due the State as administration expense is not adequate to discharge the tax debt. This question is covered at length in Point VII.

If the several questions posed above should be answered adversely to the State and it should be determined that Congress did lawfully grant to the Bankruptcy Court the

power summarily to adjudicate concerning a State's liens for taxes affixed at the time of bankruptcy and that the State is a party to the present reorganization proceedings, then we urge that the grant of power is limited by the rule announced in *Arkansas Corporation Commission* vs. *Thompson*, 313 U. S. 132. That Point (Point VIII) and the subsequent Points, each of which is urged in the event that such point should be reached in our stated "progression," need not be explained here. We believe that each point is sufficiently explained in its proper order. We have set forth the above explanations because of the need of an orderly development of the argument concerning jurisdiction. We respectfully urge that, if this order is followed, the several questions will become more clearly outlined and lend themselves more readily to a proper solution.

POINT II.

In answer to certain wholly unsupported arguments presented by the petitioner.

The petitioner had seen fit to make certain arguments that are so completely without merit that they require refutation at the very beginning of our argument.

A. *The petitioner's argument concerning the inchoate nature of the State's tax liens is specious.*

The petitioner states at page 53 of his brief that,

> "The alleged lien asserted by the State of New Jersey against the debtor for taxes is in the nature of an inchoate statutory lien."

Thus upon such incorrect premise he seeks to build a straw man for the purpose of knocking him down.

The taxes in question were finally fixed and determined by the State Tax Commissioner in advance of the date fixed by law for the taking effect of the State's lien. The assessing procedure for, let us say, the year 1939 started on March 1, 1938. (R. S. 54:22–1.) The Commissioner was required to complete his valuations by November 1, 1938, and on or before December 10, 1938, serve a statement of the assessed valuation. It was then provided (R. S. 54:26–2) that the State Tax Commissioner should sit on the second Monday of January, 1939, to review his assessments. R. S. 54:26–3 provided that a railroad may be heard concerning the incorrectness of any assessment. By R. S. 54:26–4 it was provided that hearings should be completed prior to April 1, 1939. By R. S. 54:26–7 provision was made for review by the State Board of Tax Appeals by filing of a complaint before the third Monday of June, 1939.

The said tax for the year 1939 became a lien upon all the lands, tangible property and franchises of the Debtor used for railroad purposes on June 1st (R. S. 54:27–4). Nothing further was required to be done to establish such lien. That such was the legislative intent is clearly borne out by R. S. 54:28–5. In that section provision is made for sale of property under execution. It provides for the sale of property "on which the tax was assessed or became a lien." (Property used for railroad purposes.) It then provides that as to "any other property" "the judgment and execution shall constitute or become liens in the same manner and to the same extent as other judgments and executions of the Supreme Court." Clearly nothing further was required to be done to make the liens fully effective upon the land, tangible personalty and franchise of the railroad company used for railroad purposes in the State. But even more significant are the provisions of N. J. R. S. 54:27–6 whereby

"a person having an interest in a mortgage or other lien" may pay the amount of the tax and interest due and whereby, thereafter, the taxes and interest thereon "shall continue a lien" for the benefit of such person. The lien of the State was not inchoate for nothing further was to be done. The State's lien had attached because it was the legislative intent. *Jersey City* vs. *Kelly*, 134 N. J. L. 239 (E. & A. 1946). The means taken to insure protection of its tax levies was proper. It was incidental to the taxing power which the State has as one of the attributes of its sovereignty. *Union Pac. R. Co.* vs. *Peniston*, 18 Wall. 29; *Nathan* vs. *Louisiana*, 8 How. 82; *Lane County* vs. *Ryan*, 7 Wall. 76; *Ward* vs. *Maryland*, 12 Wall. 428.

B. *The petitioner's argument concerning the choice of remedies provided by the State tax law is without merit.*

The Petitioner (pg. 40) argues that the New Jersey tax act authorizes several remedies for the collection of delinquent taxes. Such remedies were not mutually exclusive but were complementary one to the other. Thus by R. S. 54:28–1 it is provided that if the tax levied shall remain in default for ten days, the Attorney-General shall forthwith start enforcement proceedings. By R. S. 54:28–2 it is provided that he shall forthwith apply for an order of execution.

When this Court denied certiorari to review the Circuit Court of Appeals judgment in *Lehigh Valley R. Co.* vs. *Martin*, 100 F. (2d) 139, the Attorney-General started his enforcement proceedings but was enjoined by Order No. 3 (R. pg. 195). To assert that the State officials elected a remedy, even if the power to elect existed, seems far-fetched. We have been kept from the enjoyment of our rights by the Court. This Court met such a situation in *Michigan* vs. *Michigan Trust*, 286 U. S. 334, 346 (1931), by saying:

> "To protect through a receiver the enjoyment of corporate privileges and then to use the appointment as a barrier to the collection of the tax that should accompany the enjoyment would be an injustice to the State and a reproach to equity."

But the petitioner answers his own question. He states that by electing, the State has waived the State's lien. Where is there such a grant of power to any official? We will endeavor to answer the claim under Point VII.

Just what did our Legislature mean? It is hornbook law that there is no personal liability for taxes unless the law clearly provides for such personal liability. Thus the limit of liability for property taxes is the property itself. But with respect to railroads having special privileges and immunities in the operation of their properties, the State created personal liability. So that by N. J. R. S. 54:27–4, providing that the said taxes should be a debt, the New Jersey Legislature simply established such personal liability for such taxes and gave the State an additional fund to look to if the security afforded by its lien should be inadequate. This is in keeping with the intent as shown above in R. S. 54:28–5 providing for the taking effect of a lien upon "other property" in the event of entry of judgment.

C. *The argument of the Petitioner concerning compliance with the Settlement Acts is without merit.*

The petitioner has predicated his argument upon an alleged compliance with the Settlement Acts. By Chapter 290 of the Laws of 1941, it was provided that settlement documents must have the approval of the Attorney-General. If the said Chapter 290 did constitute an offer, nevertheless, under the rule that any acceptance of an offer must fully comply with the terms of the offer, there was no acceptance in the instant case.

It does not help the petitioner's argument to allege the ministerial nature of the Attorney-General's participation. The fact is he did not participate and therefore there could be no compliance. The railroad companies and the Legislature were well aware of the impasse which had been created for they sought to cure the situation by amending the law to eliminate the Attorney-General's participation. (Chapter 241, P. L. 1942.) But on the very day that the said Chapter 241 became law, the Chancery Court issued its injunction preventing the State Treasurer from accepting any tenders under the Settlement Acts.

The question of purported compliance should no longer be in issue here. The Circuit Court of Appeals in *In re Central Ry. Co.*, 136 F. (2d) 633, disposed of it long ago when it said: (638)

> "The final contention that the issue between the State and the trustees is moot by reason of the tender to the Treasurer of a payment pursuant to Order No. 163 must also fail. The tender though acknowledged was not accepted by the Treasurer and consequently was without legal effect. In fact the Treasurer was powerless to accept the tender by reason of the injunction issued by the Court of Chancery."

The Circuit Court in the just mentioned case permitted the trustees of the debtor to continue to make tenders pending a final determination of the constitutionality of the Settlement Acts by the New Jersey Courts but when such determination was made and the acts were declared to be unconstitutional, the matter should have ended. There was not and never could have been compliance with the said Settlement Acts. *New Jersey* vs. *Erie R. R. Co.*, 23 N. J. Misc. 203 (S. Ct. 1945).

with the many other Section 77 proceedings instituted during the recent depression period. Not one that we can find has proceeded on the assumption that a State, having a pre-existing lien for property taxes, could be made to participate in a reorganization plan and to accept some sort of evidence of debt instead of the cash required to be paid by the laws of the said State for the privilege of owning property with a fixed situs in such State.

The purpose of the said Section 77 being the rehabilitation of this debtor and there being no clear statement that Congress intended that a State could be compelled to participate in a plan of reorganization, we urge that Section 77 should be held to apply only to claims of a private nature and not to a situation where a State has liens for taxes affixed at the time of bankruptcy.

In *Grand Boulevard Inv. Co.* vs. *Strauss*, 78 F. (2d) 180, 185 (C. C. A. 8th 1935), the Court said:

> "It is needless to multiply excerpts from Section 77B showing the purpose and scope of the section. We think it clear that the scope and purpose of the section were, broadly speaking, the same as of Section 77; and that the powers conferred upon the court to carry out the purpose of the section were equally broad with those conferred in Section 77."

In *Thompson* vs. *Terminal Shares*, 104 F. (2d) 1, 7 (C. C. A. 8th 1939), the Court said:

> "The intent and purpose was to make Section 77 in that regard substantially, if not completely, identical with Section 77B so far as jurisdiction was concerned."

We believe that purpose and scope is the same in both sections with respect to the question presently before this Court. But we urge that Congress intended to concern itself only with a readjustment of private rights. It did not

contemplate a situation where a State has liens for taxes which had attached prior to the commencement of Section 77 proceedings.

By Section 77 (U. S. C. A. 205 (1) it is provided that:

> "A plan of reorganization within the meaning of this section (1) shall include provisions modifying or altering the rights of creditors generally or of any class of them, secured or unsecured, either through the issuance of new securities of any character or otherwise."

If Congress intended to include a State having liens for taxes within a Section 77 proceedings, then in view of the just mentioned provision we would have to ask ourselves—May the Federal Government put the State in the railroad business without its consent? And if this is answered in the affirmative, then we might very well ask—Could the Federal Government under the bankruptcy power put the State in the bakery business or the shoe business or the button business, if similar broad language were used by Congress in Section 77B?

We shall hereafter discuss the question of the State's participation in the capital set-up of any corporation, a situation proscribed by the Constitution of many of our States.

B. *Concerning status of State's liens.*

The State of New Jersey had liens for taxes for the tax years 1932 to 1939 inclusive. All of such taxes were liens upon the lands, tangible personalty and franchises of the Debtor, the latest having attached on June 1, 1939, nearly five months prior to the filing of the Section 77 petition on October 30, 1939. (N. J. R. S. 54:27-4.) As we have pointed out above, all questions as to the validity and amount of such taxes had been made res judicata by *Central Ry. Co.*

D. *The petitioner's argument regarding the existence of consideration is without merit.*

The petitioner at page 79 of his brief argues that there was consideration for the abatement of the interest payments. Of course that question is finally determined. The New Jersey Court of Errors and Appeals in *Wilentz* vs. *Hendrickson*, 135 N. J. Eq. 244 has said there was no adequate consideration. To the same effect is *New Jersey* vs. *Erie R. Co., supra.* The Court in the former case aptly characterized the alleged existence of a meritorious dispute concerning the tax assessment as follows:

> "In the light of these facts, in the light of the lack of any new issues involved, and in the light of the fact that there is no proof that the debt is not collectible, it becomes altogether clear that the asserted rights of the railroad taxpayers are 'illusory' rather than real."

See also *Murphy* vs. *West New York*, 132 N. J. L. 111.

We need not look to the New Jersey Courts alone for an expression of opinion as to the lack of any remaining real issues on July 22, 1941, the date of the passage of the first Settlement Act. In *In re New York S. & W. R. Co., supra,* the Court said concerning the same matter:

> "We insist upon a proscription of futility."

We respectfully urge that there was no consideration. But even if there were some consideration, the weight or effect to be given such consideration, is of necessity a question for the State Courts to determine. We must remember we are dealing with a State Constitution and, if that, which would otherwise be denominated a gift and violative of Article 1, paragraph 20 of our State Constitution, can be legalized by the mere "trifling inconvenience to one party or a slight advantage to the other" as urged by the peti-

tioner, then this great protection designed to prevent just such gifts to just such corporations becomes a sorry joke, a flimsy imitation for the strong bars and sturdy walls which had been intended. As shown above at page 6, there were sufficient assets to pay the amount in full. In such a situation, the Legislature was prohibited by our fundamental law from abating any part of the past due principal or interest. *Murphy* vs. *West New York, supra.* The New Jersey Supreme Court in a case involving the State Constitution said in *Gimbel* vs. *Peabody,* 114 N. J. L. 574, 577: "Time may not inure to the advantage of those who would flout the Constitution of the State."

E. *The Petitioner's statement that on October 30, 1939, the 1932 to 1939 taxes were in issue and being litigated is erroneous.*

The Petitioner states on page 7 of his brief that, when the present Section 77 petition was filed, the "1932 to 1939, inclusive" taxes were being litigated.

Just what the reasoning of the Petitioner is that leads to any such result we fail to comprehend. On such date, all litigation concerning the 1932 and 1933 taxes had ended when, this Court having refused to grant certiorari to review the Circuit Court's judgment in 100 F. (2d) 139, the Debtor filed its petition to stop the Attorney-General from proceeding with enforcement procedure. The claim, however, is indicative of the complete unwillingness of the Debtor and its Trustee to face realities.

F. *The Petitioner's statement that it was the settled law that Bankruptcy Courts had inherent power to ascertain the validity, amount and priority of all liens, including tax liens of a State, is unsupported by any authority.*

The Petitioner at page 62 of his brief states that, even before the 1938 amendment to the Bankruptcy Act, "it was the settled law that Bankruptcy Courts, as part of their

inherent power, had jurisdiction to ascertain the validity, amount and priority of all liens, including the tax liens of a State, and that if a State in a bankruptcy proceeding did not appear, it incurred the risk that its tax claim, even though secured by a lien, might be forever barred." The Petitioner cites not one single case for this so-called "well settled law" in so far as a tax lien of a State existing at the time of bankruptcy is concerned.

As pointed out above (pg. 32), the Petitioner has shown cases where claims have been made against assets available for unsecured creditors under Section 64. *New York* vs. *Irving Trust Co., supra,* and *Lyford* vs. *City of New York* are examples. Cases have been cited where the State has sought to perfect an inchoate lien. *Van Huffel* vs. *Harkelrode, supra; Lyford* vs. *State of New York, supra,* and *Straton* vs. *New, supra.* With particular reference to the *Van Huffel* vs. *Harkelrode* case, no objection was made to the Bankruptcy Court's jurisdiction generally. The sole question was whether the Court could proceed in a summary manner or whether a plenary suit was required. We repeat—the Petitioner has cited not a single case to support the rule stated by him to be the "well settled law" in so far as the pre-existing liens of a State for taxes are concerned.

G. *The Petitioner's argument concerning interest is without merit.*

We shall endeavor to show in Point V that Congress has so clearly defined the powers of Bankruptcy Courts with respect to penalties that it has become clear that no power was granted to review questions concerning the amount of interest charged for default. It was so held in *Meilink* vs. *Unemployment Compensation Commission,* 314 U. S. 564 (1942), where it was said:

> "We must give credit to the State Legislature acting within its constitutional sphere like that accorded to Congress acting in its constitutional sphere."

Our case is on all fours with the *Meilink* case. N. J. R. S. 54:27–4 clearly satisfies the test. Furthermore, another section (R. S. 54:23–4) clearly provides for a penalty. The New Jersey Court of Errors and Appeals cited the *Meilink* case in *Wilentz vs. Hendrickson, supra* (pg. 256), to support its finding that the charge is interest as distinguished from penalty. There is no doubt of the state of the law and there is therefore no authority in the Bankruptcy Court whatsoever to consider the interest question sought to be raised summarily by the Petitioner.

POINT III.

Congress did not intend to include a State with tax liens affixed at the time of bankruptcy within the meaning of "Creditor" and "Claims" as used in Section 77.

When, on April 17, 1939, this Court refused certiorari to review the judgment of the Circuit Court of Appeals with respect to the 1932 and 1933 taxes of the Debtor (*Lehigh Valley R. Co.* vs. *Martin, supra,* 306 U. S. 651), litigation concerning such taxes should have come to an end. The several moves of the Debtor in these proceedings thereafter disclose that the Debtor thinks otherwise and that he is apparently of the notion that, by the simple expedient of instituting Section 77 proceedings, a debtor may wipe all that has gone before and argue anew issues long since made res judicata. The Trustee in his petition of August 14th frankly admitted that the Section 77 petition was filed because of

> "threats by the State of New Jersey to enter judgment against the debtor upon certain claims and to sell the railroad properties of the debtor located within the State of New Jersey * * *." (R. pg. 45, par. 4.)

On page 7 of his present brief, the Petitioner claims that on October 30, 1939, the liability of the Debtor for taxes and interest for the years 1932 to 1939 were being litigated, this over six months after this Court refused certiorari in the 1932 and 1933 case as set out above (pg. 4).

We have already shown that the Court's Order No. 3 (R. pg. 195) restraining the State's collection proceedings was proper in that the said Court was authorized to maintain the status quo during the period necessary to determine whether an adequate plan of reorganization can be developed. But beyond that there is no power. As we shall endeavor to show, Congress did not intend to and could not constitutionally compel a State with tax liens to be a party to a plan of reorganization without its consent. With respect to any contention that Congress intended to empower the Bankruptcy Court to relitigate or redetermine the validity or amount of the said 1932 and 1933 taxes, such contention has been definitely and conclusively disposed of by this Court in *Arkansas Corporation Commission* vs. *Thompson*, 313 U. S. 132, *supra*.

At the time of the filing of the Section 77 petition, the Debtor's 1934, 1935 and 1936 taxes were being litigated in the Federal courts. On November 27, 1940, the Circuit Court of Appeals decided all questions concerning such taxes adversely to the Debtor in *Central Railroad Co.* vs. *Martin*, 115 F. (2d) 968, the Court saying at page 972 that the several issues had been made res judicata by *Central Railroad Co.* vs. *Martin*, 114 N. J. L. 69. It does seem therefore that any contention that Congress had empowered the Bankruptcy Court to relitigate or redetermine the amount and validity of such taxes has been definitely and conclusively disposed of adversely to the Debtor by the said *Arkansas Corporation Commission* case.

Taxes were levied for 1937 and 1938 under the same law and by the same method. The New Jersey Court of Errors and Appeals commented upon the appeals for such years as

follows in *Wilentz* vs. *Hendrickson*, 135 N. J. L. Eq. 244, 259:

> "The railroad taxpayers appeals for these years, substantially based upon the same inefficacious pattern of attack, was decided adversely to them on May 13, 1941. *State Board of Tax Appeals-Central Railroad Company of New Jersey* vs. *Martin*, 19 N. J. Misc. 427; 20 Atl. (2d) 330."

The 1939 taxes of the Debtor were before the Circuit Court of Appeals on a review of order No. 171 in these proceedings, the matter being determined adversely to the Debtor in *In re Central Railroad Co.*, 136 F. (2d) 633; Cert. den. 320 U. S. 805.

It would thus appear that the *Arkansas Corporation Commission* case is dispositive of all issues presented by the petition of August 14th concerning the amount and validity of the taxes for all the years 1932 through 1939. The Court below so held.

Good judgment might perhaps dictate that we open our argument in support of the reasoning below. But the Court below, in refusing to answer certain fundamental questions posed by the State, has left unanswered that most important question—Just how much power did Congress intend to give the Bankruptcy Court with respect to a State's liens for taxes affixed at the time of the institution of Section 77 proceedings?

Unless this vital question can be answered at this time, the State of New Jersey already considerably harrassed with seemingly endless litigation with respect to these taxes, may be compelled twice more to come before this Court—first, in opposition to a claimed power to include the New Jersey taxes in a reorganization scheme otherwise than on the basis of cash payments; and, secondly, in opposition to a claimed power in the Bankruptcy Court to compel the

State to participate in a plan providing for other than cash payment upon the State's refusing to participate voluntarily in such plan.

The State is mindful of the rule that this Court will avoid decision upon any point beyond the particular issues necessary to a determination of the cause presently before the Court. We respectfully urge that the present matter is before this Court in such fashion that the all-important question of the extent of jurisdiction may be finally determined in this present action without in any way doing violence to such rule, particularly since the interests of the people of our State are so vitally involved in this matter, affecting as it does the very backbone of the State's fiscal policy.

It is urged that Congress never intended that the rights of a State acquired as an incident of its taxing policy should be the subject of readjustment in railroad reorganization proceedings. We believe that Congress intended to deal only with rights arising ex contractu and ex delictu, except with respect to interests of the United States Government as specifically set forth, and that Section 77, properly construed, discloses nothing to support the conclusion that Congress intended to depart from its historic position of non-interference in matters of State concern. It must be admitted that nothing could be more peculiarly or particularly of State concern than the levying of property taxes and the providing for an adequate scheme for the collection thereof.

In developing this point, we shall deal with, (1) concerning the purpose of Section 77, (2) the status of the State's liens, (3) certain limitations already expressed with reference to the extent of power granted by Section 77 by Court decision, (4) what we believe Congress actually did intend by Section 77, and (5) what Congress must have intended to preserve the constitutionality of the said Section 77.

A. *Concerning the purpose of Section 77.*

Section 77 has for its main purpose the rehabilitation of a debtor Railroad Company. *Connecticut Ry. Co.* vs. *Palmer,* 305 U. S. 493, 501. (1939.) It contemplates the Debtor's continued corporate existence. *Thompson* vs. *State,* 98 F. (2d) 108 (C. C. A. 8, 1938). By such section Congress sought to avoid the delays, costs and sacrifices of liquidation.

A study of the many reorganizations proceedings conducted under the said Section 77 will disclose no instance where the Court has held that a State could be compelled to participate in a reorganization plan—to accept other than cash for its taxes when a plan has finally been evolved. There have been cases where it has been held that Section 64 is applicable in Section 77 proceedings. Those cases will be considered under Point IV hereinafter. We are presently concerned only with the intent of Congress with respect to Section 77 by and of itself.

In the very recent case of *Reconstruction Finance Corporation* vs. *Denver & R. G. R. Co.,* 66 S. Ct. 1282, this Court stated that the basic problems of railroad reorganization under Section 77 had been recently considered in *Ecker* vs. *Western Pacific R. Co.,* 318 U. S. 448 and *Group of Institutional Inventors* vs. *Chicago, Milwaukee & St. Paul R. Co.,* 318 U. S. 523. In the said *Denver & Rio Grande* case Mr. Justice Reed mentioned the "private welfare" of creditors and stockholders (pg. 1303). He spoke of the risks assumed by investors and speculators in railroad securities. Quite obviously Mr. Justice Reed was speaking throughout of private rights, those arising ex contractu and ex delictu. He was not dealing with rights acquired by public authority as an incident of a State's taxing power.

The *Western Pacific and Milwaukee* cases are not otherwise. The plan outlined in both had to do with the readjustment of obligation arising out of contract. And so

vs. *Martin*, 115 Fed. (2d) 968, citing *Tait* vs. *Western Maryland Ry. Co.*, 289 U. S. 620, and *Lehigh Valley R. Co.* vs. *Martin*, 100 F. (2d) 139.

We are not concerned in this case with a situation where a governmental body has adopted a policy of governmental investment in corporate enterprises or of investment in farm loans as in the case of certain western states. We are concerned only with the narrow question of the power of a State to levy taxes and to provide for a ready method for the collection of such taxes. As we stated above, we have no quarrel with a rule of law which puts it in the power of the Court to maintain the status quo pending a determination of the feasibility of reorganization. It is our insistence that beyond that the Court has no further power and Congress never intended to grant any such further power.

In *McCulloch* vs. *Maryland*, 4 Wheat. 316, 429, Chief Justice Marshall pointed out that the power to tax "is an incident of sovereignty, and is coextensive with that to which it is an incident." That the State in the instant case had the power to tax is no longer open to question. All Federal questions were determined adversely to the debtor with respect to the taxes involved in the present controversy in the two cases set out above. (100 F. (2d) 139 and 115 F. (2d) 968.) The power to tax set forth by the Chief Justice as "an incident of sovereignty" and "coextensive with that to which it is an incident" would be somewhat illusory if it having been determined after extensive litigation that the amounts are due, a State could be compelled to take income bonds or otherwise participate in the corporate set-up of a reorganized railroad company instead of receiving the cash for which it has waited so long.

We believe that we can demonstrate that Congress never intended that a State should participate in a reorganization plan. We believe that Congress intended to deal only with private rights and that, with respect to State matters, such matters were not intended to be handled in a Section 77 proceedings.

C. *Concerning limitations on power under Section 77.*

In *Thompson* vs. *Terminal Shares,* 104 F. (2d) 1, 5, cert. den. 308 U. S. 559, the Court said:

> "The inquiry here, however, is not as to what Congress might have done, but as to what it actually did with respect to the jurisdiction of the Bankruptcy Courts in enacting and amending Section 77."

The Court then said (p. 9) that it was not the intent of Congress that the Bankruptcy Court should take over all litigation between the debtor and third parties. The Court in that instance was dealing with a claim of the trustee against a third party. But it was a private claim and more susceptible of inclusion within the broad grant of power under Section 77 than the rights of the State in the instant case which are wholly public in nature and an incident of the retained sovereignty of the said State.

In *Palmer* vs. *Massachusetts,* 308 U. S. 79, 83, Mr. Justice Frankfurter said for this Court:

> "Plainly enough the District Court had no power to deal with a matter in the keeping of state authorities unless Congress gave it. And so we have one of those problems in the reading of a statute wherein meaning is sought to be derived not from specific language but by fashioning a mosaic of significance out of the innuendoes of disjoined bits of a statute. At best this is subtle business, calling for great wariness lest what professes to be mere rendering becomes creation and attempted interpretation of legislation becomes legislation itself. Especially is wariness enjoined when the problem of construction implicates one of the recurring phases of our federalism and involves striking a balance between national and state authority in one of the most sensitive areas of government."

In the just mentioned case, this Court was dealing with regulations having to do with the intra-state operations of a railroad. In such operations the Federal Government may at least have an indirect adverse interest. In our case we are dealing with property taxes—the very right of a State to carry on its normal fiscal functions—one of the attributes of its retained sovereignty. In this matter so vital to the very existence of the State, it would seem that the reasoning of the learned Justice would apply with even greater force.

D. *Concerning the intent of Congress with respect to the States' tax liens in Section 77 proceedings.*

The Interim Report of the standing master, upon which the District Court relied in holding that it had the requisite jurisdiction to undertake the determinations sought by the petition of August 14, gives Section 64 of the Bankruptcy Act as the source of the authority. The necessity, in this case and in other cases, of finding some authority outside Section 77 itself to substantiate the claimed power lends weight to our contention that Section 77 of itself does not give power to the Bankruptcy Court to adjudicate concerning a State's lien for taxes affixed at the time of the filing of a Section 77 petition.

If it had been intended by Congress that a State having a paramount lien for its taxes, as in the instant case, could be brought into Section 77 proceedings by the mere serving of notice and without its consent, then two situations detrimental to the sovereignty of our State could be created: (1) Upon refusal of our State to participate in any proceedings for reorganization, the taxes would be wiped out and the company could be reorganized free and clear of the State's liens for taxes. (U. S. C. A. 205 (c) (7); and (2) A plan under authority of Section 77 (b) could provide that a State having a paramount lien carrying interest during default at 1% per month could be com-

pelled to take bonds with interest payable on a when earned basis or become a stockholder in the enterprise, notwithstanding specific constitutional prohibition against stock ownership, the only test being whether the plan in the opinion of the Court is fair and equitable.

In approaching the question of intent we must be constantly aware that "opposition to the Constitution came not from any apprehension of danger from the extent of power reserved to the States" but "entirely through fear of what might result from the exercise of the powers granted to the central government" *South Carolina* vs. *United States* 199 U. S. 437, 456 (1905). This was said with respect to a conflict of governmental powers. We urge that with respect to a conflict between a State and private individuals concerning rights in property, there can be but one answer. The States never intended to grant any right of supervision.

Ours is a Union of States. *Coyle* vs. *Smith* 221 U. S. 559. Any construction that would interfere with our federal scheme must be carefully avoided. The Bankruptcy Act must be interpreted in the light of the purpose to be attained. Such a rule concerning the construction of constitutional provisions was stated for this Court in *Prigg* vs. *Pennsylvania* 16 Peters 539, 610 (1842). We must determine the mischief to be remedied. *Craig* vs. *Missouri* 4 Peters 410, 431 (1830); *Rhode Island* vs. *Massachusetts* 12 Peters 657, 723 (1838). We are primarily concerned with a reconstructed corporate set-up.

It is our purpose in this sub-point to show that Congress never intended to grant the claimed power. We believe that, before this Court will read into Section 77, a Congressional intent that a sovereign State may be compelled to become a party to Section 77 proceedings or else be deprived of its liens for taxes because of nonparticipation—a proposition so unalterably opposed to the principle of Federal noninterference in matters purely of State concern—there must be clear and unmistakable language to

such effect. We shall try to show that, not only was there no such clear language, but that the Congressional intent is quite the contrary.

The purpose behind the enactment of the reorganization legislation was to provide a scheme for the readjustment of corporate financial structures to the end that any reorganized company might meet its several obligations and continue to function as a successful operating railroad with the protection afforded to its property and operations by State laws.

(1) *Congress did not intend to include a State's liens within the scheme of Section 77 proceedings.*

What then did Congress intend? By Section 77 (b) it is provided:

> "The term 'securities' shall include evidences of indebtedness either secured or unsecured, bonds, stock, certificates of beneficial interest therein, certificates of beneficial interest in property, options, and warrants to receive, or to subscribe for, securities. The term 'stockholders' shall include the holders of voting-trust certificates. The term 'creditors' shall include, for all purposes of this section all holders of claims of whatever character against the debtor or its property, whether or not such claims would otherwise constitute provable claims under this Act, including the holder of a claim under a contract executory in whole or in part including an unexpired lease.
>
> "The term 'claims' includes debts, whether liquidated or unliquidated, securities (other than stock and option warrants to subscribe to stock), liens, or other interests of whatever character. For all purposes of this section unsecured claims, which would have been entitled to priority if a receiver in equity of the property of the debtor had been appointed by a Federal

Court on the day of the approval of the petition, shall be entitled to such priority and the holders of such claims shall be treated as a separate class or classes of creditors."

Was it intended that taxes should be included within the word "debt" or that the word "lien" included the tax liens of a State?

Taxes are the means of distributing the cost of government. *Carmichael* vs. *Southern Coal Co.* 301 U. S. 495, 509 (1937); *Welch* vs. *Henry* 305 U. S. 134, 144 (1938).

In *New Jersey* vs. *Anderson*, 203 U. S. 483, 492 (1906), this Court said:

> "'Taxes are not debts. It was so held by this Court in the case of *Oregon* vs. *Lane County*, reported in 7 Wallace. Debts are obligations for the payment of money founded upon contract, express or implied. Taxes are imposts levied for the support of the Government, or for some special purpose authorized by it. The consent of the taxpayer is not necessary to their enforcement. They operate in invitum. Nor is their nature affected by the fact that in some States—and we believe in Tennessee—an action of debt may be instituted for their recovery. The form of procedure cannot change their character.'"

See also *Missouri* vs. *Ross*, 299 U. S. 72, aff. 80 F. (2d) 329 (C. C. A. 8th 1935); *In re Reimer*, 82 F. (2d) 162, 164 (C. C. A. 2nd 1936); *In re Brezin*, 297 F. 300 (D. C. N. J. 1924) 305; *In re Gould Mfg. Co.*, 11 F. Sup. 644.

The same rule has been stated by our State Courts. In *Baker* vs. *East Orange*, 95 N. J. L. 366, 367 (N. J. Sup. 1920), it was said:

> "A tax, in its essential characteristics, is not a debt nor in the nature of a debt. A tax is an impost levied

by authority of government. *City of Camden* vs. *Allen*, 26 N. J. L. 398."

In the just-mentioned case, the Court held that neither the Federal Government nor the State was a creditor within the meaning of the Act under consideration. That there was a decided distinction between debts and taxes when the bankruptcy clause was put into our Constitution is clear. Again in 1867 we find the distinction maintained. By 14 Stat. 517, ch. 176, sect. 28, a State is given priority in the distribution of a debtor's estate for "all debts due to a State" and "for all taxes and assessments made under the laws of such State." (Meaning unsecured debts and taxes.) As late as 1940, Congress in Section 67 (b) and (c) speaks of "taxes and debts" due a State.

Cursory examination of the authorities might lead to the hasty conclusion that there has been a decided change in the rule. Thus this Court in *Liberty Mutual Life Insurance Co.* vs. *Johnson Shipyards Corp.*, aff. *Stripe* vs. *United States*, 269 U. S. 503, held that the statute under review showed a clear intent that taxes should be included within the word "debt." The Circuit Court had held (6 F. (2d) 752, C. C. A. (2d) 1925) that taxes were not included. In that case the Court had before it the right of the government to receive certain moneys. And so with the many cases which seemingly have ignored the distinction. They have gone off on the question of whether the government was to receive the benefit of an Act. Any other ruling would have produced a result the law-making body would never have intended. The Court in each instance found the clear intent to have the taxes in those cases considered as debts. This has been the limit of any change.

We are not primarily concerned in a Section 77 proceedings with the collection by the Government of taxes due but with the development of a plan whereby the corporate structure of a private corporation may be revamped. It is true

that the corporation in question is carrying on a business affected with the public interest, but nevertheless it is a business conducted with private capital for private gain. And so we are confronted with the question whether Congress intended that a State having, in the words of Chief Justice Marshall, the power to tax for governmental purposes as "an incident of sovereignty" and "coextensive with that to which it is an incident" (*McCulloch* vs. *Maryland, supra*), should be a "creditor" under the meaning of Section 77 and subject to the jurisdiction of the Court in the reorganization of a private corporate structure.

Referring then to the definitions contained in Section 77 (b), set out above, we note that the Act first defines "securities." Notwithstanding the paramount nature of the State liens, there is no mention of such liens in this definition. Obviously the State would not be included within the definition "stockholder." All of the interests sought to be covered by the terms of the reorganization provisions with the exception of the claims and the interests of the United States stem out of the definition of the word "creditor."

Notwithstanding the cited cases which have distinguished the use of the word "debt" and permitted taxes to be considered as debts under specific provisions of a given statute, when to the advantage of the taxing authority, we do not find that there has been any change in the construction placed upon the term "debtor-creditor" relationship. A debtor-creditor relationship arises ex contractu. *State* vs. *Rowe* 188 N. W. 107, aff. 13 Wall. 373; *Perry* vs. *Washburn* 20 Cal. 318, 350. The emphasis placed upon the word "creditor" throughout the said Section 77 (b) must lead to the conclusion that Congress intended to include within the meaning of "securities" and "creditor" only those private relationships and undertaking involved in the corporate structure prior to bankruptcy.

The reference in the said section to the many detailed and specific types of debts, claims, liens and securities and the absence of any reference to State and municipal taxes and liens for such taxes of itself should be cogent proof that Congress never intended such public rights to be affected by any such plan of reorganization. All specific references being to liens of a private nature, the word "lien" as used in the definition of the word "claims" must be read to mean private liens of a nature similar to those specifically enumerated in the said Section 77. *Noscitur a Sociis.* This is the only reasonable construction that can be placed upon the language of the said section consistent with the constitutional limitations upon Congress and the attitude of Congress generally toward tax claims as we will hereafter develop. Any other construction must lead to the conclusion that the State could be required to participate in a plan of reorganization and unwillingly become an owner in the enterprise pursuant to Section 77 (b) which provides:

> "A plan of reorganization within the meaning of this section (1) shall include provisions modifying or altering the rights of creditors generally or of any class of them, secured or unsecured, either through the issuance of new securities of any character or otherwise;"

The several members of Congress must have been well acquainted with the law of the several States. It is specifically provided by Article 9, Section 6, of the Pennsylvania State Constitution that the Commonwealth shall not become a stockholder in any company, association or corporation. By Article 8, Section 4, of the Ohio State Constitution, there is provided a similar prohibition. And so in California, by Article 12, Section 13, of its Constitution. These are but a few of the several State constitutions specifically prohibiting any such ownership.

The Legislature of the State of New Jersey has already appropriated to certain municipalities a portion of the taxes and interests due in the instant case. If a State is to receive bonds and stock in lieu of cash in extinguishment of its present tax lien, a portion of such bonds and stock must be turned over to the municipalities entitled to the proceeds of the tax. By Article 1, paragraph 19, of the New Jersey State Constitution, it is provided that no municipality shall be directly or indirectly the owner of any stock or bonds of any corporation. Similar provisions are found in the constitutions of many of our States. Could Congress, in view of the historic policy of non-interference in matters confided to the several States, have intended that the several States and municipalities should violate this provision of the Constitution?

Section 77 (e) makes provision in cases where the United States of America is a creditor or stockholder. The Act clearly makes a distinction between the case where the United States Government has an interest of a proprietary or quasi-proprietary nature and one where it has a claim for taxes or customs duties. The argument was made below that the failure similarly to refer to a State's rights and claims shows an intent to permit the inclusion of such rights and claims regardless of a State's consent. We submit that the reference proves just the contrary. This section simply prescribes a method whereby duly authorized persons may, under certain circumstances, give the requisite consent of the Federal Government. It is of significance that it was found necessary to set forth such claims specifically and that the claims of the Federal Government were not considered by Congress to have been included within the broad definition of creditors and claims as set out earlier in the Act.

It seems obvious that the Bankruptcy Court would have no jurisdiction without the specific consent of Congress with respect to the claims of the United States of a

proprietary or quasi-proprietary nature. We urge that such specific consent must be found within the laws or the Constitution of the State of New Jersey before similar jurisdiction can be said to have been given to the Bankruptcy Court in the case of claims of a purely governmental nature such as the tax liens in the instant case. Congress does not possess the right to authorize any State officer to deal with or consent to the inclusion of the rights of our State in any plan of reorganization. This is a matter solely for the State Legislature, just as the inclusion of Federal claims was a matter of Federal concern. This point will be developed at length hereafter in the next sub-point.

With respect to the claims of the United States, it is significant that Congress did not include taxes and customs duties due to the United States within the provisions of the general classification of creditor, but on the contrary a specific provision is made for the payment of any adjusted amount due on taxes or customs duties in cash. Congress thereby shows a clear intent to treat taxes upon a different basis than ordinary claims arising out of contract, concerning which ordinary claims a plan of reorganization may provide for some method of payment other than by cash.

The Corporate Reorganizations Provisions of the Bankruptcy Act clearly reveal the Congression intent concerning the use of the word "creditor." In 11 U. S. C. A. Section 506, it is provided in part that "claims shall include all claims of whatever character against a debtor or his property;" a creditor shall mean "the holder of any claim;" and that debts "shall include all claims." By Section 599 it is provided that "if the United States is a secured or unsecured creditor or stockholder of a debtor, the claims or stock thereof shall be deemed to be affected by a plan under this chapter" and the Secretary of the Treasury is given authority concerning the acceptance or rejection of a plan. Notwithstanding the broad language just used, the said Section 599 then goes on to provide for a case in which

"the United States is a secured or unsecured creditor on claims for taxes or customs duties." This proves two things (1) that taxes never were intended to be included within the broad definition of claims, nor the taxing authority within the broad definition of creditor. (2) It shows furthermore than Congress had no particular motive arising out of the public nature of a railroad enterprise when it made the provisions in Section 77 concerning the participation of the United States in the reorganization scheme.

It is the logic of the *Palmer* case, *supra*, that, unless there is a clear and unmistakable grant of power to the Bankruptcy Court to make adjudications and determinations concerning a State's tax liens in Section 77 proceedings, this Court in support of the ancient doctrine of non-interference in matters of strictly State concern must find no grant of power in the Bankruptcy Court to consider other than private interests in a railroad reorganization proceedings. While we believe that the language used by Congress in the said Section 77 shows a definite intent to use the word "creditor" in the manner in which it has generally been used—in connection with arrangements arising out of contract—we need not rely alone upon this as proof of the Congressional purpose. Of even greater force is the attitude of Congress throughout the Bankruptcy Act wherein there has been demonstrated a fixed and definite policy and purpose to preserve the rights of State taxing authorities.

By Section 17 (11 U. S. C. A. Section 35), it is provided that discharge in bankruptcy shall not discharge a bankrupt from any amount "due as a tax levied by * * * the State." Is there any reason why Congress could have intended that the ordinary private individual who had gone into bankruptcy should not be discharged of taxes due to a State while a private corporation engaged in the railroad business should be given different treatment? By Section 64 (a) (11 U. S. C. A. 104 (a)) unsecured taxes are given a position of priority in the distribution of the estate of a

bankrupt before dividends to general creditors. By Section 67 (b) (11 U. S. C. A. Section 107 (b)), it is provided that statutory liens will be valid even though arising or perfected within the four-month period. By act of January 8, 1934 (28 U. S. C. A. Section 124 (a)), it is provided that a trustee in bankruptcy conducting a business

> "shall be subject to all state and local taxes applicable to such business, the same as if such business were conducted by an individual or corporation."

With particular reference to the non-dischargeability of State taxes under Section 17, we wish to point out the inconsistency that results from a necessary construction of Section 77 (l) and Section 77 (f) if our tax liens are held to be claims, and the State a creditor under the said Section 77. As shown on page 63 of Petitioner's brief, Section 77 (l) provides that the rights and liabilities of creditors and the duties of a debtor shall be the same as if a voluntary petition for adjudication had been filed and a decree of adjudication entered on the day when the debtor's petition was filed. Thus on that day a private debtor would have owed taxes to the State which, under the said Section 17, were nondischargeable. But by Section 77 (f) it is provided that a plan shall be binding upon a creditor regardless of his participation and the property dealt with shall be free and clear of all claims against the debtor. Clearly these two provisions can only be reconciled if "claims" mean only private claims and "creditor" means only those having claims arising ex contractu or ex delictu.

Congress quite obviously has sought carefully to preserve the rights of taxing authorities generally. In view of this clear purpose, it may not be said that Congress was so unmindful of the rights of a sovereign State to be paid its taxes as to put it within the power of the Bankruptcy Court in a railroad reorganization proceedings under Sec-

tion 77 to compel a State to surrender its sovereign immunity—its right to have the power to tax treated as "an incident of sovereignty" and "co-extensive with that to which it is an incident"—and submit to participation in Section 77 proceedings or in the alternative to have its tax liens completely wiped out as provided in Section 205 (c) (7). The Court in *In re Gustave Schaefer* 103 F (2d) 237, 241 (C. C. A. 6th 1939) said that it was unnecessary to decide whether Congress could deprive a State of its common law or statutory lien for taxes. We respectfully urge that the question should be answered. We shall point out hereafter that any such grant of power would be unconstitutional. We have tried to confine our discussion under the present sub-point to argument showing the lack of a clear intent on the part of Congress to grant any such power.

2. Congress could not constitutionally grant the claimed power without a State's consent and so in the absence of a positive provision for consent, it must be construed that Congress did not intend to grant such power.

We shall hereafter in Point VI present the argument that, if Congress did intend to grant the power to include a State having pre-existing tax liens in section 77 proceedings, then such grant of power must be subject to the consent of the State (1) because it would otherwise be an unwarranted and unnecessary interference in a matter of strictly State concern and (2) because, with particular reference to determinations sought by the petition of August 14, the making of such determinations would constitute a suit or suits against the State. We are concerned here with the lack of intent.

The language of Section 77 appears to be broad and definite. If the State under the circumstances of our case is a creditor, then the State must file its claims or be barred

notwithstanding the nature of its liens or the time of their taking effect. There is no mention of consent of the State. In this sub-point we shall therefore argue that, if Congress intended the Act to be operative in our case, consent is requisite and that in the absence of a provision for such consent the said Section 77 would be unconstitutional. However, the said Section, in the light of what has been said in sub-point D (1) above, can be reasonably construed as not to include a State's tax liens within its meaning. In keeping with the long established rule that, where there are two constructions one of which would result in a finding of unconstitutionality and the other in a finding of constitutionality, the Court will arrive at that construction which will render the Act constitutional, we will urge that this Court should find that Congress did not intend to grant the claimed power to the Bankruptcy Court. *Plymouth Coal Co.* vs. *Pennsylvania* 232, U. S. 531 (1914); *United States* vs. *Jim Fuey Moy* 241 U. S. 394 (1916); *The Abby Dodge* 223 U. S. 166 (1912).

In *Ashton* vs. *Cameron County*, 298 U. S. 513, 531 (1936), this Court said:

> "Neither consent nor submission by the States can enlarge the powers of Congress; none can exist except those which are granted. *United States* vs. *Butler*, decided January 6, 1936, 297 U. S. 1. The sovereignty of the State essential to its proper functioning under the Federal Constitution cannot be surrendered; it cannot be taken away by any form of legislation. See *United States* vs. *Constantine* 296 U. S. 287.
>
> Like any sovereignty, a State may voluntarily consent to be sued; may permit actions against her political divisions to enforce their obligations. Such proceedings against these subdivisions have often been entertained in Federal Courts. But nothing in this tends to support the view that the Federal Government,

acting under the bankruptcy clause, may impose its will and impair state powers—pass laws inconsistent with the idea of sovereignty."

The power of the State to tax the property in question having a situs within our State cannot be questioned. Such power is one of the State's attributes of sovereignty. *Union Pac. Ry. Co.* vs. *Peniston* 18 Wall, 5, 29, 21 L. Ed. 787 (1873); *Ohio Life Insurance Co.* vs. *Debolt,* 16 How. 416, 428, 14 L. Ed. 997 (1853); *Lane County* vs. *Oregon* 7 Wall, 71, 76, 19 L. Ed. 101 (1868). A state has plenary power to tax all property within its limits unless specifically restrained by force of federal law and as a necessary incident of such power to provide appropriate means for the enforcement of collection of such taxes. *U. S.* vs. *Hester* 137 F. (2d) 145 (C. C. A. 10th 1943). The State has general power to create a lien for its debt. *Lyford* vs. *State of New York* 140, F. (2d) 840, cert. den. 323 U. S. 714.

On the other hand, Congress has the power to establish uniform laws on the subject of bankruptcy. Is there any conflict here? We believe not except with respect to the aforementioned requirement that a State must forego enforcement of its liens pending the determination by the Court of the feasibility of a plan of reorganization.

To understand our present problem we must consider the historical development of the subject. In Blackstone's Commentaries Book II, page 487 et seq., the subject is discussed at length. We see there the limitation both upon the persons who may avail themselves of the benefits of the Act and upon the property available for distribution to creditors.

The history of bankruptcy legislation in the United States is set forth at length in *Hanover National Bank* vs. *Moyses,* 186 U. S. 181, 184, 186 (1902). In that case at page 189, the distinction between debts and taxes is maintained. We have pointed out above the legislative policy of clearly

differentiating between debts and taxes in the 1867 Bankruptcy Act. (14 Stat. 517, Sect. 28), and again in Section 67 (b) and (c) of the present Act. We learn that, while the persons who may resort to bankruptcy voluntarily or be forced into involuntary bankruptcy has been from time to time enlarged, generally changes in the Act have been with respect to the contractual relations of parties unable to meet their debts.

Mr. Justice Cardozo in his dissenting opinion in *Ashton* vs. *Cameron County*, 298 U. S. 513, 535 (1936), stated concerning the origin and growth of the bankruptcy power that:

"The history is one of an expanding concept."

He then lists (pg. 535) the changes that have taken place in such expanding concept. In every instance such changes had to do with the question of who could avail himself of the bankruptcy privilege or the question of the voluntary or involuntary nature of the proceedings. The two opinions in the *Cameron County* case and the opinion in the later case of *United States* vs. *Bekins*, 304 U. S. 27 (1938), adopting the dissenting opinion, should be dispositive of the question of whether or not Congress may without a State's consent compel it to submit to reorganization proceedings under Section 77 or lose its tax liens affixed at the time of bankruptcy. The answer is unquestionably—No!

In the *Cameron County* case, there was presented a situation where a political subdivision of a State sought to avail itself of an amendment to the Bankruptcy Act devised for the relief of local governments. There is no doubt that the municipalities for whose benefit the amendment was passed were in sore need of assistance. The complaining parties were private individuals whose rights arose out of the contract obligations of such municipalities. Because of the contract clause of the Constitution, the majority held the

Act to be unconstitutional. The reasoning of the majority was characterized as follows by Mr. Justice Cardozo in his dissent (pg. 541):

> "To hold that this purpose must be thwarted by the Courts because of a supposed affront to the dignity of a State, though the State disclaims the affront and is doing all it can to keep the law alive, is to make dignity a doubtful blessing."

There we were dealing with the contract obligations of a hard-pressed municipality—a proper subject of bankruptcy. Here we are dealing with the sovereign's right to be free from interference in matters of its fiscal policy.

If we examine the two opinions in the *Cameron County* case and the opinion in *United States* vs. *Bekins, supra,* we must come to the conclusion that, on the basis of all of the opinions, Congress would not have the power to authorize the Bankruptcy Court to include the tax liens of a State affixed at the time of bankruptcy in a Section 77 proceedings without the State's consent. In fact from the majority opinion in the earlier case a very creditable argument could be made that there is no power at all to include such liens because of the provisions of many State Constitutions concerning the making of gifts (*Wilentz* vs. *Hendrickson* (135 N. J. L. Eq. 244)), and the provisions already mentioned concerning the owning of stocks and bonds of private corporations. The said majority opinion states (pg. 530):

> "Neither consent nor submission by States can enlarge the powers of Congress: none can exist except those which are granted."

We will not press this last-mentioned point at this time because our purposes are fully served if this Court finds the requirement of consent.

In the dissenting opinion, page 543, Mr. Justice Cardozo points out the "care with which the governmental powers of the State and its subdivisions are maintained inviolate." Chief Justice Hughes carries on from there in *United States vs. Bekins, supra.* At page 53, we find

> "As the States were at liberty upon obtaining the consent of Congress to make agreements with one another, we saw no room for doubt that they may do the like with Congress if the essence of their statehood is maintained without impairment. And we added that 'Nowhere in our scheme of government—in the limitations express or implies of our federal constitution—do we find that she (the State) is prohibited from assenting to conditions that will assure a fair and just requital for benefits received.'"

and again at page 54,

> "The bankruptcy power is competent to give relief to debtors in such a plight and, if there is any obstacle to its exercise in the case of the districts organized under State law it lies in the right of the State to oppose federal interference. The State steps in to remove the obstacle. The State acts in aid, and not in derogation, of its sovereign powers. It invites the intervention of the bankruptcy power to save its agency which the State itself is powerless to rescue. Through its cooperation with the national government the needed relief is given. We see no ground for the conclusion that the Federal Constitution, in the interest of state sovereignty, has reduced both sovereigns to helplessness in such a case."

So much with reference to a political subdivision of a State unable to meet its contract obligations. Considering the above and considering the comment of Mr. Justice Car-

dozo concerning the distinction between a State, which is "a sovereign or at least a quasi-sovereign," and its local governmental units, we must be impressed that, under the rule of law as expressed in those cases, the State may not be made a party to a Section 77 proceedings, without its consent, and any attempt by Congress to compel participation without such consent would be unconstitutional.

Is there any clear requirement for consent set forth in such section? The answer is in the negative. Therefore it would seem that if Congress did intend to include the State within the terms of Section 77 the Act would be unconstitutional to that extent. But did Congress so intend? A very reasonable construction of the said Section 77 leads to the conclusion that Congress intended only private contract relationships to be considered in the reorganization plan. As pointed out above a Court will not arrive at a construction of an act which renders it unconstitutional unless clearly compelled to do so by the express language of the statute. *Plymouth Coal Co.* vs. *Pennsylvania, supra; United States* vs. *Jim Fuey Moy, supra;* the *Abby Dodge* vs. *United States, supra.* We feel that this Court should find that there was no such intent and that Section 77 does not apply to pre-existing tax liens.

In conclusion of this point, we respectfully urge that Congress did not intend to grant to the Bankruptcy Court the claimed power. This does not mean as suggested by the petitioner that a debtor or its trustee must accept as final any amount stated by a State's fiscal officer to be due. Every remedy that was open to the Debtor before bankruptcy is still available to the Trustee. Every remedy that any other railroad company may have is presently available. The Trustee simply does not have an additional remedy by reason of the institution of Section 77 proceedings. This is quite in harmony with Mr. Justice Frankfurter's view as expressed in *Palmer* vs. *Massachusetts, supra,* as follows:

> "But the whole scheme of Section 77 leaves no doubt that Congress did not mean to grant to the district courts the same scope as to bankrupt roads that they may have in dealing with other bankrupt estate."

It may be said that delay may be caused by any requirement for going to other courts. That argument is without merit because of the known lengthy procedure involved in all such reorganizations. But even were there a probability of some delay, that could not change the law for as said in *Chicago* vs. *Fieldcrest Dairies,* 316 U. S. 168, 171 (1942):

> "Consideration of delay, inconvenience, and cost to the parties which have been urged upon us, do not call for a different result. For we are here concerned with the much larger issue as to the appropriate relationship between federal and state authorities functioning as a harmonious whole."

This is wholly in keeping with the view expressed in *Arkansas Corporation Commission* vs. *Thompson, supra,* wherein we find:

> "But there is nothing in the history of bankruptcy or reorganization legislation to support the theory that Congress intended to set the federal courts up as super assessment tribunals over state taxing agencies."

POINT IV.

Congress did not intend that Section 64 should be applicable in Section 77 proceedings.

Jurisdiction was assumed by the District Court under Section 64 (a) (U. S. C. A. Sect. 104 (a)) of the Bankruptcy Act which provides in part:

> "That in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court."

In *Arkansas Corporation Commission* vs. *Thompson, supra,* this Court held that it was unnecessary to determine whether Section 64 (a.) is applicable in Section 77 proceedings because, on the facts of that case, no authority existed to make the determinations sought even if the said Section 64 were generally applicable. As we shall point out in greater detail in Point VIII, the facts in the instant case are even more favorable to the State of New Jersey than the facts presented by the Arkansas case. In our case the Courts had already adjudicated concerning the taxing method employed by this State in reviews of the very taxes involved in the present cause.

But regardless of the amount of prior litigation and regardless of the remedies afforded in the State tribunals, we believe it was not the intent of Congress to have Section 64 (a) applicable in Section 77 proceedings with respect to pre-existing liens for the reason that (1) Section 64 is applicable only where liquidation is required and (2) in no event could 64 apply in the instant case because Section 64 has no application where valid liens exist.

A. *Section 64 applies only in case of liquidation.*

Congress could not have intended that Section 64 should be applicable in Section 77 proceedings for the reason that such Section 64 contemplates situations arising in liquidation and the philosophy of liquidation is directly opposite to that of reorganization. Section 77 on its part was designed for the purpose of readjusting private rights and not to review state taxing methods.

The Courts in construing Section 64 prior to the passage of the said Section 77 have stated that the purpose of Section 64 was to have tax claims ascertained and determined before the first dividends were declared. *In re Starin,* 12 F. (2d) 471; *Cohen* vs. *United States,* 115 F. (2d) 505. It was designed to assist the Court in winding up the affairs of the bankrupt and distributing his estate as promptly and inexpensively as possible. Apparently only unadjudicated tax claims were in contemplation.

It takes but a casual reading of Section 77 to demonstrate that, in a Section 77 proceeding, which contemplates only the preservation of the status quo of an operating railroad company during the time necessary to determine the feasibility of reorganizing the financial structure of such railroad company, there is no such urgency. Assume the maximum of effort, yet the time necessarily involved in developing a plan, having it passed upon by the Interstate Commerce Commission, sent to the District Court for approval, returned to the said Commission for a vote, and again returned to the District Court in the event of the necessity of applying the "jam-down" provisions of the said section, must be considerable. There is a sufficient time to secure any needed determination concerning tax liability in a plenary suit. There is not the urgent need of using the summary procedure of bankruptcy as there is in the case of liquidation.

We respectfully urge that Congress never intended to supplant the State Courts in matters affecting a State's tax lien interests. *Palmer* vs. *Massachusetts, supra.* It sought in certain limited cases to have the Federal Court make certain determinations under Section 64, the balance of convenience in those cases being sufficient to take the matter away from the State Courts. But even in such cases, there was established a very definite limitation—the section was made applicable only in a case where a taxing authority, otherwise having no security for its taxes, seeks a priority under the said Section 64. Even in such a case a State does not have to make a claim. *New York* vs. *Irving Trust Co., supra.* Also any review is limited to the question of the State's right to share in free assets. *Henderson County* vs. *Wilkins, supra.*

The provision concerning the review of taxes contained in the proviso is of necessity limited in its application by the general purpose of the said Section 64. That purpose is the distribution of the bankrupt's assets to general creditors. This section was first enacted in 1892 as part of the bankruptcy law and was amended at various times until its enactment in its present form in 1938 (52 Stat. 874, C. 575). Prior to March 3, 1933 (11 U. S. C. A. Sect. 205), there was no provision in the bankruptcy law relating to railroads or to their reorganization in the Bankruptcy Court. It follows therefore that Section 77 proceedings were not in contemplation of Congress when it enacted Section 64. Nothing in the 1938 amendment or elsewhere indicates that Congress intended that Section 64 should apply in Section 77 proceedings. On the contrary in 1940, we still see Congress differentiating between taxes and debts. (Sections 67 (b) and (c).) In a matter so vital to local sovereignties, it is inconceivable that Congress would have remained silent if it had intended that such section should be applicable to the tax liens of a State existing at the time of the institution of Section 77 proceedings.

The taxes in question were levied as an incident of sovereignty. The Federal Courts have already held these very taxes to be free of constitutional objection. 100 F. (2d) 139; 115 F. (2d) 968. Certainly it may not be said that there could have been an intent to oust our State Courts of jurisdiction in the circumstances of this case for, as stated by this Court in *Boteller* vs. *Ingels*, 308 U. S. 57, 61 (1939), an

> "Immunity from local laws will not be read into the bankruptcy act."

It does seem that certain provisions of Section 64 are wholly inapplicable to and inconsistent with Section 77 proceedings. The section speaks of payment of dividends to creditors and repeatedly of the "bankrupt." In Section 77 proceedings a railroad in reorganization is referred to as the "debtor" and not as a "bankrupt." This Court, in *Lowden* vs. *Northwestern National Bank & Trust Co.*, 298 U. S. 160, 164, wherein the Court refused to apply Section 57 to Section 77B proceedings, said:

> "A proceeding to reorganize is not a bankruptcy, although an amendment to the bankruptcy act creates and regulates the remedy."

In view of what was said by this Court in *Boteller* vs. *Ingels, supra,* to the effect that:

> "The Act of 1934 indicates a congressional purpose to facilitate—not to obstruct—enforcement of State laws: the court below correctly recognized and applied this congressional purpose * * *,"

we urge that this Court should determine that Section 64 was not intended to apply in Section 77 proceedings.

Comparison with the former Section 77B is revealing. A decree adjudicating a petitioner a bankrupt and directing a liquidation of the company is impossible under Section 77, although it was expressly provided in Section 77B. With respect to Section 77B proceedings, Section 64 was made applicable by express provision of the law. It was applicable, however, only where reorganization had been found impossible and it became necessary to resort to liquidation. In *City of Springfield* vs. *Hotel Charles Co.*, 84 F. (2d) 589 (1936), and again in *Eldredge Brewing Co.* vs. *City of Portsmouth* 118 F. (2d) 410, 413 (1941), the First Circuit in a Section 77B proceedings held that Section 64 had no application to tax claims unless and until an order of liquidation. To the same effect are *In re A. V. Manning's Sons*, 16 Fed. Supp. 932; *In re New York O. & W. Railroad Co.*, 25 Fed. Supp. 709, and *Texas Co.* vs. *Blue Way Lines, Inc.*, 93 Fed. (2d) 593.

There was a similarity of purpose in Section 77 and Section 77B of the Bankruptcy Act. One extended relief and the remedy of reorganization to railroad corporations (Section 77) and the other to non-railroad corporations. So long, therefore, as reorganization is the objective of the proceeding, like rules of applicable law and procedure should prevail. The cases cited above show that so long as Section 77B proceedings remained a reorganization proceeding, Section 64 did not apply. Since Section 77 proceedings are never anything else but reorganization proceedings, in logic Section 64 should never apply in said Section 77 proceedings. As pointed out above, the time element is not of such importance in reorganization as it is when the proceedings become liquidation proceedings. In fact, there is no such time element and no reason why Congress should have departed from its time-honored policy of non-interference in matters strictly of State concern such as the matters which are presented in the instant case concerning the rights of a sovereign State to have

questions concerning the levy and assessment of State taxes determined in the manner provided by State laws.

B. *Section 64 has no application where liens exist.*

That the Master has misunderstood the problem with which we are confronted is clear from his treatment of Section 64 (a) of the Bankruptcy Act on pages 15 and 16 of his interim report. He states that the said Section 64 (11 U. S. C. A. Section 104) gives the Court jurisdiction to adjudicate the amount and validity of the tax liens of the State.

As we shall later point out, any construction of Section 64 that would permit an adjudication concerning the rights of a State without its consent would be unconstitutional. We urge here, however, that Section 64 can have no applicability to the pre-existing tax liens of the State since the said section deals only with the question of the priority of unsecured claims against the general assets of the debtor's estate after all liens and encumbrances have been provided for. It applies only to those who have no lien upon such assets, and who, but for the said Section 64 (a), would have no priority in such assets. The said section does not affect valid liens. *Miners' Savings Bank of Pittston* vs. *Joyce*, 97 F. (2d) 973 (C. C. A. 3rd, 1938); *Ingram* vs. *Coos County*, 71 Fed. (2d) 889 (C. C. A. 9th, 1934); *In re Brannon*, 62 F. (2) 959 (C. C. A. 5th, 1933), cert. den., 289 U. S. 742, sub. nom. *Ryan* vs. *City of Dallas; In re Know-Powell-Stockton Co.*, 100 F. (2d) 979 (C. C. A. 9th, 1939); *Strom* vs. *Peikes*, 123 F. (2d) 1003 (C. C. A. 2nd, 1941); *In re Weil*, 46 F. Supp. 14 (D. C. Pa. 1942); *In re Wilkes-Barre & E. R. Co.*, 46 F. Supp. 12 (D. C. Pa. 1942); *Hidalgo and Cameron Counties* vs. *American R. S. L. & I. Co.* 103 F. (2d) 509, 513 (C. C. A. 5th 1939); *In re Martin* 75 F. (2d) 618, 621 (C. C. A. 7th 1935).

In *In re Brannon, supra,* 62 F. (2d) 959 (C. C. A. 5th 1933), cert. den., 289 U. S. 742, sub. nom. *Ryan* vs. *Dallas,* the Court stated the rule at page 960:

> "Section 64 gives the rule for paying out the money arising from the bankrupt's property which remains for general distribution after all special liens and encumbrances have been dealt with. * * * On the other hand, where the creditor before the bankruptcy has an established lien on the bankrupt's property which binds it as to third persons and which is not invalidated by the bankruptcy, he does not come under the operation of section 64."

In the present case, of course, the tax debt to the State of New Jersey, both for principal and interest, is secured by a statutory lien on all of the lands, tangible property and franchises of the Debtor situated in this State. R. S. 54:27–4; R. S. 54:27–6; *Wilentz* vs. *Hendrickson, supra,* where it was stated (133 N. J. Eq., at p. 466):

> "The reference to the obligation for which a lien is given embraces the accrued interest."

This construction was approved by the Court of Errors and Appeals (135 N. J. Eq. 244, at pp. 253-4).

Any power in the Court to review taxes under Section 64 must thus be with reference only to the State's right, if claimed, to share in the assets of the Debtor upon which the State has no lien. This could only happen if the State has exhausted the security covered by its lien upon the said lands, tangible property and franchises and there should remain a deficit.

The case of *New Jersey* vs. *Anderson,* 203 U. S. 483, cited by the intervenors heretofore, is inapplicable as dealing only with taxes not secured by a lien. This was specifically

pointed out in *In re Brannon, supra* (62 F. (2d), at p. 960). The *New Jersey* vs. *Anderson* case was also distinguished in the *Arkansas Corporation Commission* case.

The cases cited by the petitioner do not dispute this rule. In *New York* vs. *Irving Trust Co., supra*, the Court was dealing with unsecured claims just as in the *New Jersey* vs. *Anderson* case. Again in *Lyford* vs. *City of New York, supra*, application for distribution had been made against general assets. In *Lyford* vs. *State of New York, supra*, the State was seeking to establish a lien. It had no pre-existing lien and so was the moving party.

The distinction is perhaps most clearly brought out by *In re Thornycroft*, 120 F. (2d) 469 (C. C. A. 2nd 1941). In that case the taxing authority had a lien subordinate to certain mortgages. The property was not sufficient to pay the mortgages. The said authority sought to gain an advantage under Section 64, but it was held that Section 64 applied only after all liens were discharged.

We, therefore, submit that the Bankruptcy Court received no power to make adjudications concerning the pre-existing tax liens of the State by reason of Section 64. The fact that the Trustees and Master were forced to rely solely upon Section 64, which has nothing to do with pre-existing liens, for authority to undertake the determinations sought by the petition of August 14, is compelling proof that Congress never intended to give the Bankruptcy Court any power to adjudicate summarily concerning such liens under any circumstances whatsoever.

POINT V.

Neither Sections 57 or 67 of the Bankruptcy Act give jurisdiction to the Bankruptcy Court to adjudicate in a summary manner concerning the pre-existing tax liens of the State.

In their argument below the petitioner and the bondholder relied upon Section 64 (a) as the source of authority to review the taxes in question. The Master in his Interim Report (R. pg. 38) placed reliance upon such section. It appears that the bondholders now rely upon the broad powers contained in the Act and that the petitioner for the first time places great reliance upon Sections 57 (11 U. S. C. A. 93) and 67 (U. S. C. A. 107) to sustain their contention that the Bankruptcy Court is empowered to undertake the review sought by the petition of August 14th. We respectfully urge that neither section grants the claimed power.

A. *Section* 57 (11 *U. S. C. A.* 93) *does not grant the power to make the said adjudications.*

That Section 57 deals only with the estate of the bankrupt, as we understand such estate, is shown clearly by subsection (e) which provides for the temporary participation in creditor's meeting of secured creditors to the extent only that their claims exceed the value of their security. Further by subsection (n) it is provided that only the claims provable under the bankruptcy act shall be proved and filed in the manner provided in the said Section 57. In other words some authority must be found outside the said Section 57 before it may be held that there has been a grant of power. As we have pointed out, the provision of the Bankruptcy Act are applicable to the estate of the bankrupt only and are not at all concerned with distributing other than that actually owned by the said bankrupt, what is left after all valid liens have been taken care of.

We also respectfully submit that it is apparent that Section 57 is concerned primarily with liquidation. It is concerned with dividends—the parcelling out to the several creditors of that which is available for payment of those whose claims are against the general assets of a bankrupt. The argument submitted above in Point IV-A concerning Section 64 is likewise applicable with respect to the said Section 57. A railroad reorganization is not concerned with liquidation. Its purpose is to keep a railroad together as a unit, as a going concern. *Continental Bank* vs. *Rock Island, supra.*

Rather than destroying the State's argument that Congress never intended that a State's liens for taxes and the interest due thereon should be the subject of summary adjudication in a Section 77 proceedings, the said section 57 strengthens that argument. By subsection (j) it is provided that debts due to a State as a penalty or forfeiture shall be allowed for a lessened amount. The specific mention of such penalties or forfeitures shows clearly that Congress never intended to give the Bankruptcy Court power to adjudicate concerning interest. It has so been held in *Meilink* vs. *Unemployment Compensation Commission*, 314 U. S. 564 (1942), where at page 569 we find:

> "We must give credit to a state legislature acting within its constitutional sphere like that accorded to Congress acting in its constitutional sphere."

Our case is on all fours with the *Meilink* case. The New Jersey Statutes provided in R. S. 54:27–4.

> "If the taxes of the company or any portion thereof, remain unpaid on December first following the levying thereof, the company shall be considered in default and such taxes, or the unpaid portion thereof shall thenceforth bear interest at the rate of one per cent for each month until paid, notwithstanding the prosecution of a writ of certiorari or other remedy."

Reference to the statute shows that uniformly the charge for interest on account of default in payment was designated as interest and not as penalty. Furthermore there is a provision for penalty in the Act and it is specifically called a penalty. Section 54:23-4 provided for a fixed penalty, regardless of the element of time, in the event of the making of a willful return. (There is no question of any such penalty in this case.) The New Jersey Legislature has strictly maintained the distinction between interest and penalty required by the rule of the said *Meilink* case.

But in addition, the New Jersey Court of Errors and Appeals in *Wilentz* vs. *Hendrickson, supra,* has already determined that the statutory charge for default is interest as distinguished from penalty, and in arriving at that conclusion cited the just mentioned *Meilink* case. (pg. 256.)

We respectfully submit that Section 57 does not authorize the Bankruptcy Court to make the adjudication sought by the petition of August 14th.

B. *Section 67 (11 U.S.C.A. 107) does not confer the power to make the requested determinations.*

Section 67 (U. S. C. A. 107) does not grant the claimed power. On the contrary the said section shows conclusively that Congress did not intend to grant the Bankruptcy Court the power to make the determinations sought by the petition of August 14th.

We first direct attention to subsection (b) where it is provided that "statutory liens for *taxes and debts* owing to the United States or any State" may be valid even though arising within the four-month period. (Italics ours.) So that as late as August 22, 1940, Congress still continued to draw a distinction between taxes and ordinary debts. We have already stated above that the attitude of Congress as expressed in the said subsection (b) is one of careful consideration of the rights and interests of a sov-

ereign State and is wholly in keeping with the spirit which should exist if we are to strike that nice balance between national and State authority in this most sensitive area of government as suggested in *Palmer* vs. *Massachusetts*, *supra*.

But the said section proves more. The New Jersey Statute required nothing further to be done to perfect its liens. The said liens attached on June 1st of each succeeding year. The section would only have been applicable if we had found it necessary to assert a lien upon property other than that used for railroad purposes under N. J. R. S. 54:28-5.

Again in subsection 67 (c) we see the clear intent of Congress not to disturb the interest of the State to the advantage of other private lienors. Again the Act provides for "liens for taxes and debts" and then goes on to subordinate a State's liens for taxes upon personal property only, of which a State has not taken possession, to certain specific administration charges and to certain wages which became due within three months before the institution of bankruptcy proceedings. Of course in view of the specific limitation, it is clear Congress intended to have the State's liens upon personalty otherwise intact. With respect to the State's liens upon realty, they are not affected at all. They remain intact.

The most amazing thing about this whole case is that Petitioner has created the issue of the inchoate nature of lien in order to apply the provisions of the said Section 67, with respect to personalty, which is only a comparatively small portion of the property involved and of importance only in case of liquidation. Of course, in the instant case, we are concerned with reorganization and with paramount tax liens upon realty having a value far in excess of such liens. And such must be the case, otherwise there could be no reorganization. Certainly Congress could never have intended a reorganization of a company whose main stem and terminals are of a value less than the said tax liens.

The provision of the said section are clearly applicable to liquidation with respect to which we are not now concerned. We do not believe that there will be any difficulty with payment of any of the charges set forth in paragraphs 1 and 2 of Section 64. There has been no claim that the value of the liened railroad property is less than the amount of the State's liens for taxes and interest. On the contrary the only proof shows that value to be far in excess of such taxes. This Debtor will be reorganized.

We submit therefore that Congress did not grant power to the Bankruptcy Court to make the requested adjudications by anything contained in the said Section 67. On the contrary the clear intent is to leave untouched such lien interests even in a liquidation proceeding. A fortiori it may not be said that the Bankruptcy Court received the authority to undertake the determinations sought by the petition of August 14th by anything contained in the said Section 67.

The rule of *Lowden* vs. *Bank, supra,* concerning Section 77B proceedings, should be broadened to include reorganizations arising under Section 77, and it should be held that neither Sections 57 or 67 are applicable to Section 77 proceedings in so far as the pre-existing tax liens of the State are concerned.

POINT VI.

If Congress did intend to include a State's pre-existing tax liens within the plan of a Section 77 reorganization or if Congress intended to grant power to the Bankruptcy Court in any other manner to adjudicate concerning such tax liens, then any such grant of power must be subject to the State's consent, otherwise such inclusion or grant of power would be unconstitutional.

The State argued above under Point III, D(2) (pg. 70), that the State could not be made to participate in a Section 77 reorganization proceedings under the facts of the instant

case without its consent and that, since no such consent is expressly required, Congress could not have intended to include the State within the scheme of reorganization. We will urge in this point (A) that if Congress did intend to include a State with such tax liens as a creditor, then the Court must somehow read into the said section the requirement of consent, (B) that if Congress intended to give power to the Bankruptcy Court summarily to adjudicate concerning such tax liens, such grant of power is likewise subject to the State's consent for otherwise such grant of power would violate the right of a State to be immune from suit without its consent, and (C) if Congress did intend to grant the power to make such adjudications regardless of consent, then Section 77 is unconstitutional.

As we have pointed out, the Trustees have consistently refused to recognize the distinction between liens affixed at the time of bankruptcy and those that accrue subsequent to bankruptcy with respect to prior taxes. We are not concerned with those taxes that have become due subsequent to bankruptcy because, as pointed out above, they are clearly the obligation of the Trustee.

We have discussed above the changing concept concerning the persons who may be the subject of bankruptcy legislation and the broad powers that may be conferred by Congress on the Bankruptcy Courts with respect to the "estates" of such persons. There has also been a decided change in policy concerning the extent of jurisdiction given to Bankruptcy Courts with respect to interests outside the jurisdiction of the said courts at the time of bankruptcy but which affect the quantum of the estate of a bankrupt. Thus in early years the interests of mortgagees were not the subject of adjudication in a summary bankruptcy proceedings. Latterly such interests may be reviewed in such proceedings. We urge, however, that any grant of power to adjudicate concerning liens attached at the time of bankruptcy, must be subject to the requirement of due

process. While any action concerning the actual estate of the debtor does proceed in rem, any action involving a pre-existing lien must at its inception be in personam.

Section 54:27–4 of the New Jersey Revised Statutes provided:

> "These taxes shall be a lien paramount to all other liens upon all the lands and tangible property and franchises of the company in this state. The lien shall take effect on June first of the year in which the tax is payable and shall be a debt due from the company to the state on that date for which an action at law or suit in equity may be maintained, and shall be a preferred debt in case of insolvency. These remedies are in addition to the special proceedings provided for in chapters 19 to 29 of this title (§54:19–1 et seq.):"

As we have shown, a State as an attribute of sovereignty may provide adequate means for protecting its taxes. The means employed by the State has been in effect for nearly fifty-five years when the present proceedings were started. In 1884 it was provided (P. L. 1884, chap. 101, sect. 12),

> "the sum of the estimates or computation for each company shall constitute the tax to be paid by each company, and shall be a lien paramount to all other liens upon all the lands and tangible property and franchise of such company in this state; such lien shall take effect on the first day of December;"

There can be no dispute concerning the time when the liens attached in this case. The time element is important and the case was presented to the Court below so as to make the distinction clear. The State showed the difference between a case where a State had liens at the time of bankruptcy and a case where there were no liens such as in the

oft-cited case of *New Jersey* vs. *Anderson*, 208 U. S. 483. We then went on further to distinguish a situation where liens had already attached from a situation where something must be done subsequent to bankruptcy in order to have a lien attach. A supposititious case was described as follows: Let us suppose that instead of filing its petition on October 30, 1939, the Debtor had filed on May 30, 1939. The argument heretofore advanced by the State would still apply to 1932 to 1938 taxes, the latest of which in such event would have become affixed on June 1, 1938. But the taxes for 1939 would be in a wholly different position and, if this were an ordinary case of liquidation in bankruptcy, would require altogether different treatment. Since the 1939 taxes could not become a lien until June 1, 1939, the Court would have received custody of the property on May 30, 1939, subject only to the 1932 to 1938 taxes. By such custody the Court would have placed a protective wall around the estate of the Debtor, including the title and possession, and the State could not get through that protective wall in order to have its lien attach for 1939 taxes unless it obtained the permission of the Court to do so.

We made the same distinction above in this brief and made the point that, if we were concerned with liquidation, the State's position with respect to the 1939 taxes, in our supposititious case, would be exactly the same as that of the holder of any unsecured claim in so far as jurisdiction is concerned. It would have to consent to the jurisdiction of the Court for the purpose of asserting its right to have a lien for 1939 taxes, since such lien was not in existence when the Court took custody. Of course, in such an event, the State would not be urging its priority under Section 64 but under Section 67 or other provision of the Act. The above has been presented to show the importance of the distinction in an ordinary case. We believe that, in a railroad reorganization proceedings under Section 77, any taxes coming due and payable after the filing of the petition

are administration charges. Also actually the lien for 1939 taxes had attached months prior to bankruptcy.

The distinction is carefully preserved in the New Jersey statute. Whereas, the State had a lien for taxes on property used for railroad purposes on June 1 of each year for which the tax was levied, its lien on other property of the Debtor attached as follows:

> "As to any other property of the company or persons, the judgment and execution shall constitute or become liens in the same manner and to the same extent as other judgments and executions of the supreme court." (N. J. R. S. 54:28–5.)

We respectfully urge, therefore, that the question of the time of the attaching of our liens upon the property of the Debtor used for railroad purposes is free from doubt. All attached long before the filing of the petition of October 30, 1939.

A. *If Congress intended to include a State having liens for taxes at the time of bankruptcy as a creditor in Section 77 proceedings, then any such inclusion must be subject to the State's consent, otherwise the said section is to that extent unconstitutional.*

The cases setting forth the doctrine of the independence of the national and State governments within their respective spheres are set forth at length in *Ashton* vs. *Cameron County, supra*, pg. 528, et seq. *Texas* vs. *White*, 7 Wall. 700, 725; *Collector* vs. *Day*, 11 Wall. 113, 125, and *Indian Motor Cycle* vs. *United States*, 283 U. S. 570, 575, are examples. The Court then went on to say (pg. 530):

> "The power 'to establish • • • uniform laws on the subject of Bankruptcies' can have no higher rank or

> importance in our scheme of government than the power to 'lay and collect taxes.'"

This Court was there speaking of the power of Congress to "lay and collect taxes." We respectfully urge that the power of the State to lay and collect taxes is of equal rank and dignity. No interference with such power should be countenanced beyond that necessary to the proper protection of the estate of the bankrupt as that estate has been generally understood since the inception of bankruptcy laws—the debtor's or bankrupt's equity in encumbered property plus his unencumbered property.

We have set out above in sub-point D (2) of Point III our argument to the effect that Congress could not without violating the constitutional rights of the State of New Jersey compel the State to participate without its consent in a plan of reorganization (pgs. 69 to 77). We repeat that argument here.

We respectfully urge that, if this Court does find that Congress intended a State having liens for its taxes to participate in a plan of reorganization, the Court must somewhere spell out the requirement of consent, otherwise the said section is to that extent unconstitutional. Whether that consent is to be inferred from the process clause of Section 77 (a),

> "Process of the Court shall extend to and be valid when served in any judicial district."

or whether it may be inferred from the distinction which we have already made between grant of power and exercise of power or whether upon some altogether different basis, we do not venture a guess. We believe that it is the duty of the petitioner to show the appropriate language connoting the requirement of consent, otherwise the State of New Jersey may not under any circumstances be made to participate in any plan of reorganization under Section 77.

B. *If Congress intended to give the Bankruptcy Court power summarily to adjudicate concerning such tax liens, such grant of power is likewise subject to the State's consent for otherwise such grant of power would violate the right of the State to be immune from suit without its consent.*

We have pointed out at length that the State's liens had all attached at the time of the filing of the Section 77 petition on October 30, 1939. We have also shown at page 28, above, that the trustee took the property of the debtor in the same "plight and condition" in which the debtor held it prior to the said filing, *Thompson* vs. *Fairbank, supra,* and that such was the limit of the "estate in custodia legis."

(1) *The Bankruptcy Court cannot obtain jurisdiction to adjudicate concerning rights in property arising out of liens existing at the time of bankruptcy until the lien-holder has been made a party to the proceedings.*

Since the trustee in bankruptcy takes property subject to all liens existing at the time he takes custody of such property, it necessarily follows that before the Court can make any adjudication concerning the interests of any such lienor, it must obtain jurisdiction over such lienor. This was settled in *Factors' & Traders' Insurance Company* vs. *Murphy,* 111 U. S. 738 (1884), where the Court said at page 742:

> "We are of opinion, with the Supreme Court of Louisiana, that the record in this case does not show such service of process or other notice as makes Mrs. Murphy such a party to the bankruptcy proceeding as binds her to the sale and discharges of her lien. The case of *Ray* vs. *Norseworthy,* 23 Wall. 128, is conclusive on that subject, and is, we think, sound in principle."

In re Platteville Foundry & Machine Co., supra, 147 F. 828 (D. C. Wis., 1906); *In re Sanborn,* 96 F. 551 (D. C. Vermont, 1899); and *In re Pittelkow,* 92 F. 901 (D. C. Wis., 1899); are all authority for the rule that the lien interest of a lienor cannot be affected unless such lienor is made a party to the proceeding. He is not such a party by the mere institution of such proceeding.

The rule could not be otherwise, else the constitutional rights of a lienholder would be violated. As was said in *Louisville Joint Stock Land Bank* vs. *Radford,* 294 U. S. 555, 589:

> "The bankruptcy power, like the other substantive powers of Congress, is subject to the Fifth Amendment."

In *VanHuffel* vs. *Harkelrode,* 284 U. S. 225, the Court said that the selling of property of a bankrupt free of liens and transferring the liens from the property to the proceeds was the exercise of a lesser power than that of adjudicating the amount and validity of the liens. If, therefore, a sale free of liens without making the lienor a party is not binding on the lienor, as was held in the foregoing cases, a fortiori, the adjudication of the amount and validity of such liens, as is here proposed to be done, could not be binding upon a lienor unless such lienor had been served with process or other notice sufficient to satisfy the process clause and the Court had obtained the necessary jurisdiction over such lienor. We urge that in a case where a lien has attached at the time of the institution of proceedings under Section 77, the trustee in bankruptcy must be the moving party and must take adequate steps by process or other notice sufficient to satisfy the process clause in order to make the holder of any lien a party. Unless this be done, no adjudication or determination intended to be binding upon such lienor may be made.

In conclusion of this sub-point, we urge that the rule that the Bankruptcy Court takes property of bankrupts subject to existing liens of private lienors, and the rule that it can make no adjudication affecting such liens without obtaining jurisdiction over such lienors, must certainly apply with equal force when the statutory lien interest of a sovereign State is involved, particularly where as in the instant case that lien is paramount to all other liens. As was said in *Thomas* vs. *Woods*, 173 Fed. 585, 594 (C. C. A. 8th, 1909), wherein it was held that the Bankruptcy Court took the property of a bankrupt subject to the dower right of the bankrupt's wife:

> "If rights resting wholly upon private negotiation are safe, can any reason be assigned why a right created by statute in furtherance of the public policy of a State should not also be secure?"

We respectfully urge that on October 30, 1939, the Bankruptcy Court obtained jurisdiction of the property of the Debtor used for railroad purposes in the State of New Jersey subject to the pre-existing liens and that, before any binding adjudication could be made concerning any of such liens, the lien-holder must be made a party.

(2) *Since the tax liens of the State had attached prior to the institution of Section 77 proceedings, no such jurisdiction may be acquired without the State's consent.*

On October 30, 1939, the State had paramount liens for taxes upon the properties of the Debtor for the years 1932 to 1939, the latest of which had attached five months prior to the commencement of the present Section 77 proceedings. On that date could the State of New Jersey be compelled to submit against its will to the jurisdiction of the Bank-

ruptcy Court for the purpose of having the said Court adjudicate concerning the amount and validity of its tax liens, most of which had already been sustained by judgments, certiorari to review which had been denied by this Court? (Pg. 3 above.) We urge that the Bankruptcy Court has no such power either as an incident of the broad power contained in Section 77 with respect to reorganization or as an incident, as claimed by the Petitioner, of any inherent power in the Bankruptcy Court to consider any matter affecting the debtor's estate.

In *Arkansas Corporation Commission* vs. *Thompson*, 313 U. S. 132, 145, it was said:

> "But there is nothing in the history of bankruptcy or reorganization legislation to support the theory that Congress intended to set the federal courts up as super assessment tribunals over State taxing agencies."

There is no doubt that on the merits of this case, the State would ultimately prevail. To prevent, however, the necessity of submitting to expensive and burdensome litigation on matters long since declared by the Federal Courts to be res judicata, we urged our constitutional immunity in that any attempt to compel the State to submit to such jurisdiction would be a suit against the State.

Any person seeking to have such determinations made must be considered to be the moving party. He would be seeking to have binding adjudication made against the State in judicial proceedings, the making of which must constitute judgments in a suit or suits against the State. We urge that no Court can entertain such a suit unless the State consents thereto. (See cases sighted infra.)

It is not accurate to say that the State is seeking to establish rights in something that is presently within the custody of the Trustee and under the jurisdiction of the

Bankruptcy Court, and that, therefore, the State is the moving party, as was urged by the Trustee below. The contrary is the fact. The rights of the State of New Jersey, represented by its tax liens in and to such properties, were not brought within the jurisdiction of the Bankruptcy Court by the filing of the Section 77 proceedings on October 30, 1939. The Trustee did not take title to the lien interests of the State, *York Mfg. Co.* vs. *Cassell, supra; Platteville Foundry and Machine Company, supra,* but only that equity which the Debtor had immediately prior to the inception of the proceedings. The Trustee took the property in the same "plight and condition" that the Debtor had held it. *Thompson* vs. *Fairbanks, supra.*

Since the Bankruptcy Court did not have jurisdiction to adjudicate concerning the lien interests of the State in and to such property without the State being made a party to the proceedings, the said Court could not obtain such jurisdiction unless the State had consented to be made a party thereto.

It is thoroughly established that a sovereign State may not be sued in a Federal court without its consent, either by a citizen of the State, or by a citizen of another State, the freedom from suit by a citizen of another State being based upon the Eleventh Amendment to the United States Constitution, and the freedom from suit by a citizen of the State itself being based upon the inherent nature of sovereignty which prevents action against a State by its own citizens without its consent. *Hans* vs. *Louisiana,* 134 U. S. 1; *North Carolina* vs. *Temple,* 134 U. S. 22 (1889); *Hopkins* vs. *Clemsen College,* 221 U. S. 636 (1910); *Fitts* vs. *McGhee,* 172 U. S. 516 (1899); *Georgia* vs. *Jesup,* 106 U. S. 458 (1882); *Ex Parte State of New York,* 256 U. S. 490; *Murray* vs. *Wilson Distilling Co.,* 213 U. S. 151 (1909); *Worcester County Co.* vs. *Riley,* 302 U. S. 292 (1937); *Minnesota* vs. *United States* (1938), 305 U. S. 382.

A clear statement of the basis for the rule is to be found in the very recent case of *Great Northern Life Insurance Company* vs. *Read*, 322 U. S. 47 (1944), wherein Mr. Justice Reed said for this Court (pp. 51, 54):

> "Efforts to force, through suits against officials, performance of promises by a State collide directly with the necessity that a sovereign must be free from judicial compulsion in the carrying out of its policies within the limits of the Constitution. *Monaco* vs. *Mississippi*, 292 U. S. 313, 320, *Louisiana* vs. *Jumel*, 107 U. S. 711, 720. A state's freedom from litigation was established as a constitutional right through the Eleventh Amendment. The inherent nature of sovereignty prevents action against a State by its own citizens without its consent. *Hans* vs. *Louisiana*, 134 U. S. 1, 10, 16.
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> "When we are dealing with the sovereign exemption from judicial interference in the vital field of financial administration a clear declaration of the State's intention to submit its fiscal problems to other courts than those of its own creation must be found."

What constitutes a suit against a State is not circumscribed within any narrow or technical limits. In *State of Missouri* vs. *Fisk*, 290 U. S. 18 (1933), the Court held that the immunity of a State from suit extends to any proceedings wherein process is issued against a State

> "to compel it to subject itself to the court's judgment, whatever the nature of the suit."

In *Minnesota* vs. *United States*, *supra*, a proceeding against property in which the sovereign had an interest was prohibited. In *Worcester County Trust Co.* vs. *Riley*,

supra, a bill of interpleader was held to come within the prohibition.

In *Palmer* vs. *Ohio,* 248 U. S. 32, 34 (1918), the Court held that the State law, as the applicable local law is conclusive on the subject of consent to be sued. The limits to which the State of New Jersey goes in protecting itself from being subjected to process at the instances of private persons is shown in *Lodor* vs. *Baker, Arnold & Company,* 39 N. J. L. 49. In that case money of the defendant, admitted to be due to such defendant, was being held by the State treasurer. The plaintiff caused the said money to be attached. The writ of attachment was quashed on the ground that the "right to attach must necessarily involve the right to compel the State to appear as a party defendant at the suit of a private individual." The Bankruptcy Court is subject to the same general rule that a State cannot be made a party to any proceedings without its consent.

The Trustees and Intervenors have heretofore contended that the bankruptcy law is the paramount law of the land and that the State can be bound by the adjudications of the Bankruptcy Court regardless of its consent. In reaching this conclusion they fail to distinguish between a grant of power to the Bankruptcy Court, and the propriety of the exercise of that power in a particular case. We concede that the State cannot make bankruptcy laws. But we are not dealing here with a question of State jurisdiction over bankruptcy matters. We are dealing with the alleged conflicting rights in property of the State and private individuals, which rights were established prior to bankruptcy. The right to exercise any power under the Bankruptcy Act with reference to such conflicting rights is governed by the fundamental rule that requires jurisdiction over the person of the State before any such power may be exercised. We are not concerned with the quality of service. No matter how slight the requirement it nevertheless constitutes the commencement of a suit against the State. No matter how

informal the type of notice, it still must satisfy the requirement of due process and the issuance of such process, call it notice or what you will, constitutes the institution of such suit.

We respectfully submit that Congress received no right or power under the bankruptcy clause of the United States Constitution which may be construed as authority to grant the claimed power or that was intended to impair the principle of a sovereign State's immunity from suit by any individual unless the said State consents thereto. It should be remembered that the Eleventh Amendment to the Constitution was adopted for the specific purpose of preventing the Federal courts from ever again (as in *Chisholm* vs. *Georgia*, 2 Dall. 419) taking jurisdiction over a cause affecting the conflicting rights of a State and individuals without the consent of such State. Since the bankruptcy powers of Congress were contained in the original Constitution, and the Eleventh Amendment came later, any conflict or inconsistency between the bankruptcy power and the immunity of sovereign States from suit must be resolved in favor of the principle of immunity.

As the petitioner has pointed out (B. pg. 61), this Court has made clear that courts of bankruptcy are essentially courts of equity, citing *Pepper* vs. *Litton*, 308 U. S. 295; *Prudence Realization Corp.* vs. *Geist*, 316 U. S. 89, and *Heiser* vs. *Woodruff*, 66 S. Ct. 853. With this we heartily agree. And this cause is a suit in equity as contemplated by the said Eleventh Amendment.

The immunity of a State from suit by individuals without its consent cannot be taken away by any provision of the United States Constitution or by Federal laws enacted pursuant thereto. In *Palmer* vs. *Ohio, supra*, 34, the Court said:

> "The right of individuals to sue a State in either a federal or a state court, cannot be derived from the

Constitution or laws of the United States. It can come only from the consent of the State."

In *Ex Parte New York, supra,* involving the attempted exercise against a State of the admiralty jurisdiction of a Federal court, which is also derived from the United States Constitution, the Court said at page 497:

> "That a State may not be sued without its consent is a fundamental rule of jurisprudence having so important a bearing upon the construction of the Constitution of the United States that it has become established by repeated decisions of this court that the entire judicial power granted by the Constitution does not embrace authority to entertain a suit brought by private parties against a State without consent given: not one brought by citizens of another State, or by citizens or subjects of a foreign State, because of the Eleventh Amendment; and not even one brought by its own citizens, because of the fundamental rule of which the Amendment is but an exemplification."

And again at page 502:

> "The symmetry and harmony maintained in those cases consists in the uniform operation and effect of the characteristic principles and rules of the maritime law as a body of substantive law operative alike upon all who are subject to the jurisdiction of the admiralty, and binding upon other courts as well. *Chelentis* vs. *Luckenbach S. S. Co.*, 247 U. S. 372, 382, 384. It is not inconsistent in principle to accord to the States, which enjoy the prerogatives of sovereignty to the extent of being exempt from litigation at the suit of individuals in all other judicial tribunals, a like exemption in the courts of admiralty and maritime jurisdiction."

If any person seeks to have the State's pre-existing tax liens adjudicated, such persons must bring the State within the jurisdiction of the Court if any such adjudication is to be binding upon such State. As was said by this Court in *Missouri* vs. *Fiske, supra,* at page 28:

> "The exercise of the judicial power cannot be protected by judicial action which the Constitution specifically provides is beyond the judicial power. Thus, when it appears that a State is an indispensable party to enable a Federal court to grant relief sought by private parties, and the State has not consented to be sued, the court will refuse to take jurisdiction. *Cunningham* vs. *Macon & B. R. Co.,* 109 U. S. 446, 451, 457, 27 L. ed. 992, 994, 996, 3 S. Ct. 292, 609; *Re Ayers, supra* (123 U. S. p. 489, 31 L. ed. 224, 8 S. Ct. 164; *Christian* vs. *Atlantic & N. C. R. Co.,* 133 U. S. 233, 244, 33 L. ed. 589, 593, 10 S. Ct. 260; *Stanley* vs. *Schwalby,* 147 U. S. 508, 518, 37 L. ed. 259, 263, 13 S. Ct. 418; *South Carolina* vs. *Wesley,* 155 U. S. 542, 545, 39 L. ed. 254, 255, 15 S. Ct. 230; *Belknap* vs. *Schild,* 161 U. S. 10, 20, 50 L. ed. 599, 602, 16 S. Ct. 443. And if a State, unless it consents, cannot be brought into a suit by original bill, to enable a Federal Court to acquire jurisdiction, no basis appears for the contention that a State in the absence of consent may be sued by means of an ancillary and supplementary bill in order to enforce a decree."

And again at page 28:

> "The fact that a suit in a federal court is in rem, or quasi in rem, furnishes no grounds for the issue of process against a non-consenting State. If the State chooses to come into the court as plaintiff, or to intervene, seeking the enforcement of liens or claims, the State may be permitted to do so, and in that event, its rights will receive the same consideration as those of

other parties in interest. But when the State does not come in and withholds its consent, the court has no authority to issue process against the State to compel it to subject itself to the court's judgment, whatever the nature of the suit. See *The Siren*, 7 Wall. 152, 154, 19 L. ed. 129, 130; *The Davis*, 10 Wall. 15, 19, 19 L. ed. 875, 876; *Georgia* vs. *Jesup*, 106 U. S. 458, 462, 27 L. ed. 216, 218, 1 S. Ct. 363; *Cunningham* vs. *Macon & B. R. Co., supra* (109 U. S., p. 452, 27 L. ed. 994, 3 S. Ct. 292, 609; *Re New York, supra* (256 U. S., pp. 497, 500, 65 L. ed. 1061, 1062, 41 S. Ct. 588.)"

See also *Central Railroad* vs. *Martin, supra* (115 F. (2d) 968).

In conclusion of this sub-point, we respectfully submit that the relief sought by the Trustees in their petition of August 12, 1944, insofar as it seeks any adjudication concerning the tax liens of the State which were affixed prior to October 30, 1939, constitutes a suit against the State of New Jersey and may not be maintained unless the State has consented thereto.

(C) *If Congress did intend that a State having paramount liens for its taxes which had attached prior to the institution of Section 77 proceedings, may be made a party without its consent, to that extent, Section 77 is unconstitutional.*

If Congress did intend that, regardless of the rule concerning the sovereign immunity from suit, a State must become a party to Section 77 proceedings, or failing to do so, shall or may be deprived of all interest in the properties subject to its liens, then, and to that extent, Section 77 is unconstitutional. It needs no further argument to establish the point that the taxes involved in the instant case were levied by the State of New Jersey for public purposes. They are property taxes upon properties located within the State of New Jersey. The State was acting within the

limits of its constitutional power in levying such taxes. *Central Railroad Co.* vs. *Martin, supra.*

As was said by this Court in *Ashton* vs. *Cameron County, supra,* at page 531:

> "But nothing in this tends to support the view that the federal government, acting under the bankruptcy clause, may impose its will and impair state powers —pass laws inconsistent with the idea of sovereignty."

The later case of *United States* vs. *Bekins, supra,* has not changed the rule so far as consent is concerned. It is difficult to conceive of any case where Congress would more effectively interfere with the sovereign powers of the State of New Jersey than would be the case if Congress were to grant power to the Bankruptcy Court to determine and adjudicate concerning the State's pre-existing tax-lien interests, long since passed upon by courts of competent jurisdiction. Nor could there be a greater encroachment upon State powers than would exist if the said State is deemed to be a claimant and creditor under such section, and so subject to having its tax liens satisfied in some manner to be determined by the Interstate Commerce Commission and the Bankruptcy Court, but other than by payment of cash in full.

We respectfully urge that, if it was intended by Congress that a State having tax liens should be deemed to be a creditor under Section 77 proceedings, Congress also surely intended that the State must consent before it can be made a party to such proceedings. To support such conclusion we again refer to *Arkansas Corporation Commission* vs. *Thompson, supra,* wherein it was said:

> "But there is nothing in the history of bankruptcy or reorganization legislation to support the theory that Congress intended to set the Federal Courts up as

super assessment tribunals over State taxing authorities."

In *Palmer* vs. *Massachusetts, supra,* this Court, spoke of the need of wariness in the construction of language which implicates a recurring phase of our federalism and "involves striking a balance between national and state authority in one of the most sensitive areas of government." In that case this Court held that the power may not be found unless there be clear and definite words to that effect. There are no definite words in our case and we believe that any interpretation placed upon the language of Section 77, which would permit the State to be made a party without its consent, under the facts of the instant case, would be contrary to this time-honored principle.

As pointed out above, it is well established that a Court will not arrive at a construction of an act which renders it unconstitutional, unless clearly compelled to do so by the expressed language of the statute. *Plymouth Coal Co.* vs. *Pennsylvania, supra; United States* vs. *Jim Fuey Moy, supra; The Abbey Dodge* vs. *United States, supra.*

We have stated above that in our belief Congress never intended that the Bankruptcy Court should, in Section 77 proceedings, have the power to make the determination and adjudication concerning the State's pre-existing tax liens sought by the Petitioner without the State's consent. (pg. 70.) We again repeat that argument. But if such power were intended to be granted, either by Section 77 or any other section, any such grant of power with respect to such pre-existing liens must be subject to the State's consent, otherwise such grant of power would be unconstitutional.

POINT VII.

The State of New Jersey has not consented to have the Bankruptcy Court determine the amount and validity of its tax liens.

We need only consider the question whether the State has consented to participate in the present proceedings if this Court has first determined that the State's tax lien interests were not brought into Court by the mere institution of the proceedings and the consent of the State must be given before it can be made a party. Thus we consider the question of consent in the light of the circumstances that the State's tax lien interests are not within the jurisdiction of the Court and some positive act of the State is necessary to confer jurisdiction.

As we have shown above, it has been established by this Court that, before a State may be made a party to any suit at law or equity, the said State must consent thereto. It has been held that such consent may not be inferred and in *Ford Motor Company* vs. *Department of Treasury of Indiana*, 65 S. Ct. 347 (1945), that the State's immunity from suit may be even raised for the first time in this Court. Where then is the consent?

(A) *No New Jersey statute or constitutional provision authorizes the participation of the State in Section 77 proceedings in a case where the State has liens for its taxes.*

The Trustees have been unable to point to any New Jersey statute or constitutional provision authorizing any officer of the State to consent to the State's participation in these proceedings with respect to the State's tax liens. No such provision exists. Without such specific authority no effective consent can exist. *Strobel Steel Construction Company* vs. *State Highway Commission*, 120 N. J. L. 298.

(E & A 1938.) The New Jersey law, as the applicable local law, is conclusive on the subject of consent to be sued. *Palmer* vs. *Ohio, supra.*

(B) *The State Comptroller was not authorized to prosecute the enforcement of the State's railroad tax liens in this or any other proceedings, nor authorized to consent to any adjudication concerning such tax liens.*

On page 15 (R. pg. 37) of his interim report, the Master stated that the Court had jurisdiction over the kind of claims asserted by the State. He apparently adopted the contention of the Trustees that the State Comptroller has prosecuted a demand on behalf of the State against the assets of the Debtor by filing proofs of claim on behalf of the State. But what assets? Certainly they cannot mean those assets which we have demonstrated are not within the jurisdiction of the Court.

We have shown that as of October 30, 1939, the lien interest of the State was outside the jurisdiction of the Court —that the commencement of the reorganization proceedings did not, properly construing the Bankruptcy Act, and could not, constitutionally construing such Act, bring such interest within such jurisdiction without the State's consent. Nothing transpired between October 31, 1939, when the proceedings began, and December 15, 1940, when the Comptroller's proofs of claim were filed to change that condition. No officer of the State had authority to consent to any such jurisdiction. During that period, therefore, the Bankruptcy Court was powerless to make any adjudication respecting the State's liens.

The Trustees have contended that, conceding the existence of that status on December 15, 1940, the action of the Comptroller on that day brought the State's liens within the jurisdiction of the Court. We proceed to address our attention to that contention.

It is freely admitted that the Comptroller is vested by statute with the power and duty to superintend the collection and protection of the State's revenues. R. S. 52:19–10; 52:19–15. It is well settled, however, that a public officer's statutory powers and duties must be strictly construed. *Newark* vs. *Civil Service Commission,* 115 N. J. L. 26, 29, 177 Atl. 868 (Sup. Ct. 1935).

The question now presented is not one having to do with general supervision over the protection of the State's pecuniary interest, but, rather, as to the existence of specific authority to enforce the State's statutory liens for unpaid railroad taxes.

That subject is specifically provided for in detail in R. S. 54:28–1 to 54:28–6. These sections make it mandatory for the Attorney-General to enter a judgment in the Supreme Court for unpaid taxes after ten days default. Provision is then made for the sale of the property of the taxpayer in satisfaction of the tax by a Master in Chancery. These acts clearly imply a lack of power in any other State official to take any action with respect to the State's railroad tax liens which would prejudice the exclusive right and duty of the Attorney-General to enforce such tax liens in the manner specifically provided therein. The argument of petitioner to the effect that there were three alternative methods is without merit. The action in debt is additional and simply is the method of providing for personal liability where otherwise the collection of tax would be limited to the value of the particular property taxed. (See pg. 44 above.)

Clearly authoritative in this connection is the language used by this Court in *Great Northern Life Insurance Co.* vs. *Read, supra* (pg. 54). The limited functions of the Comptroller in this connection are further emphasized by the proviso in R. S. 54:28–1 that the Comptroller shall certify the amount of the tax delinquency prior to the entry of judgment or execution therefor by the Attorney-General. *Expressio unius est exclusio alterius.*

The petitioner has answered his own argument when he argues (pg. 85) that by the State officers' action, the State has lost its lien. Who could argue seriously that any officer of the State was so empowered? Before any such contingency would be permitted, clear and unmistakable language must be shown to this Court.

Since, therefore, the Comptroller possessed no authority to enforce the lien claims in question, no action by him in these proceedings can be construed as a request by the State for the enforcement of those liens by this Court. *Minnesota* vs. *U. S., supra, Adams* vs. *Bradley,* 1 Fed. Cases 93; 5 *Sawy,* 217, 219 (C. C. 1878); *O'Connor* vs. *Slaker,* 22 F. (2d) 147, 152 (C. C. A. 8th 1927); *Title Guarantee & Surety Co.* vs. *Guernsey,* 205 Fed. 94, 95 (D. C. Wash. 1913). Of course enforcement in our case; which meant the sale of the property, would be contrary to the whole scheme of reorganization and could not have been allowed even had it been requested, for as pointed out by this Court in *Continental Bank* vs. *Rock Island, supra* (pg. 671), "a railway is a unit; it cannot be divided up and disposed of piecemeal like a stock of goods. It must be sold, if at all, as a unit and as a going concern." Obviously since the State has only a paramount lien upon properties in railway use in the State of New Jersey, enforcement in any Court would defeat this aim and would be inconsistent with any scheme of reorganization.

The Comptroller could not of course have been demanding that which the State already had—its paramount liens for taxes—for we must remember that we are only concerned at this point in our argument with the facts alleged to constitute consent under the circumstances that the Court had no jurisdiction over that paramount interest of the State and that consent is necessary in order to confer jurisdiction.

Nor is the argument of the Trustees that the Attorney-General has made appearances in these proceedings in be-

half of the State's claims of any avail. That officer is subject to the same rule of strict construction of his statutory duties and powers as is the Comptroller. The Attorney-General may enforce railroad tax liens only in the manner set forth in R. S. 54:28–1 et seq.; *Great Northern Life Insurance Co.* vs. *Read, supra.* There being no ambiguity in this act, there is no occasion for the application of the rule of practical construction of ambiguous legislation, invoked below by Trustees. See *State* vs. *Wrightson,* 56 N. J. L. 126, 206, 28 Atl. 56. (S. Ct., 1893.)

The limitations upon the power of an Attorney-General to bind the State was quite recently discussed in *Ford Motor Company* vs. *Dept. of Treasury of Indiana, supra.* As we stated above, the State's immunity was raised for the first time in that case when the matter came before this Court.

C. *The filing of the proofs of claim merely constituted notice to the trustees of the existence of the State's tax liens and laid the basis, in the event of the applicability of Section 64, for making a claim in the event the liened property was insufficient to pay in full the taxes and interest due the said State.*

The need for keeping separate the consideration of the several phases of the present inquiry must now have become apparent. We have an altogether different concept of the construction to be placed upon the actions of the State's fiscal officers when we realize that the interest of the State of New Jersey as represented by its tax liens were not within the custody of the Trustee and so within the jurisdiction of the Court at the time of the filing of the so-called proof of claim, and that no step need be taken by such officers to protect the said lien interests of the State. Having in mind then the statutory limitations on the power of the Comptroller with respect to the enforcement of the

State's railroad tax liens, and having in mind that the State's lien interests were not within the jurisdiction of the Court, the question arises as to the effect of the said Comptroller's action in filing the claims. The filing of the said proofs must be construed merely as a notice to the Trustees and the Court that the State has liens for its taxes that were outside the jurisdiction of the Court, and to lay the basis for the making by the Comptroller of a claim on behalf of the State for any deficit that might arise in the event that the property of the Debtor should not be sufficient to satisfy the tax liens. (How any such deficit could be established without liquidation we do not know. However the notice would be in keeping with careful business practice.) The proofs do disclose that the State asserted its lien. It is significant that the petitioner in its petition of August 14, while setting forth the objections to the State's proof of claim subsequent to the determination in *Central Railroad Co.* vs. *Martin*, 115 F. (2d) 968, conveniently omitted the Comptroller's reply denying jurisdiction. (R. pg. 245-12.)

It is fundamental in the law of bankruptcy that a claimant must exhaust his security before he can assert a claim against the assets that are in the custody of the Court. *In re Hagin, supra, New York Trust Co.* vs. *Palmer, supra.* The latter case which was a Section 77 reorganization clearly supports our views concerning this matter. In our case, the Comptroller had no authority to do anything more than make demands against general assets when a deficit should be proved. He had no authority to bring the State's liens within the jurisdiction of the Court. Nor does the filing of the proof of claim and participation in bankruptcy proceedings waive any right of the State to rely upon its security where, as here, the proof of claim specifically called attention to the State's lien, *Thomas* vs. *Taggart*, 209, U. S. 385. (1908.)

It being the rule that the security must be exhausted before any claim be made against the assets in the custody of the Court *(New York Trust Co.* vs. *Palmer, supra)*, and it being the rule that

> "a claim proven as a secured claim is always potentially an unsecured one. If the security fails in whole or in part the equity of the case will generally require that recognition be given the unsecured debt." *McAbee* vs. *Isom*, 116 F. (2d) 1001 (C. C. A., 5th, 1940.)

it necessarily follows that the only power that may be attributed to the Comptroller, by reason of his general powers and in the absence of specific power, is with respect to a possible deficit. His only authority is to provide against the contingency that the security afforded by the lien is not sufficient to liquidate the whole tax debt, and it shall become necessary to make claim for such deficit.

The Comptroller could not, of necessity, make any estimate as to the amount of any such deficit, if in fact he contemplated any such deficit, since the enforcing authorities of the State were restrained by the Bankruptcy Court's order from enforcing the said tax liens—the only method given to the said Comptroller by law for proving the amount of the deficiency claim that the State might ultimately have to make against the general assets under Section 64 in the event that such section is at all applicable in Section 77 reorganization. We do not believe that any one has ever doubted that this Debtor would reorganize. In this connection we cannot help but comment on the argument of the Petitioner on pages 53 to 56 of his brief. Cases concerned with the inaction of taxing officials and taxing authorities slumbering on their rights have no place in our argument. It cannot ever be said other than that the State of New Jersey has constantly pressed the matter.

The very limited scope of any review by the Bankruptcy Court in the event it should have become necessary to press a claim under Section 64, is set forth in *Henderson County* vs. *Wilkins*, 43 F. (2d) 670, 672 (C. C. A., 4th, 1930). The Court said concerning such limitation in a case where a claim for taxes was made against general assets:

> "Its action is not a review of the action of the taxing authorities or a proceeding to enjoin action by them, but a determination under the statute of the amount which should be paid on the claim for taxes from the assets of the estate in its possession. *In re E. C. Fisher Corporation* (D. C.), 229 F. 316, 318."

Thus even if Section 64 is applicable in these proceedings, its application is limited to any claim the State may make against general assets available for unsecured claimants and, in any review of such claim by the Bankruptcy Court, the said Court could determine only whether the State is entitled to a share of such general assets. Beyond that the said section confers no power on the said Court.

In conclusion of this point, we therefore urge that, since the Court did not have jurisdiction of the State's rights in the property of the Debtor as represented by its pre-existing tax liens, it must be apparent that the action of the Comptroller could only have been intended at most to constitute a potential demand against assets which were within the custody of the Court (those not affected by the State's pre-existing liens and available for distribution to unsecured creditors). The said Comptroller was powerless to in any way affect such pre-existing lien interest of the State. That lien interest has never been brought into Court, may not be brought into Court without the State's consent and the State has never consented nor authorized anyone to give the consent necessary in order to confer jurisdiction on the Bankruptcy Court over the said State with respect thereto.

POINT VIII.

Even if Congress intended that Section 64 should be applicable in Section 77 proceedings, the Bankruptcy Court, under the rule of *Arkansas Corporation Commission* vs. *Thompson, supra*, is without power to make the determinations sought by the petition of August 14.

As stated above, the Trustees in their argument below and the Master in his Interim Report considered Section 64 as the source of authority for the Bankruptcy Court to make the review sought by the Trustees in their petition of August 14. A similar question was before this Court in *Arkansas Corporation Commission* vs. *Thompson, supra.* In that case this Court said that it was unnecessary to decide whether the said Section 64 is applicable to Section 77 proceedings because, conceding the applicability of the said section generally, the Bankruptcy Court was without jurisdiction to review the disputed tax assessments for the reason that an adequate judicial review was afforded by the laws of the taxing State. This Court said at page 144:

> "If the trustee had availed himself of his right of appeal to the courts of Arkansas, with an ultimate right of appeal to this Court for final determination of federal questions, it is difficult to believe that it would now be seriously argued that Congress, by § 64 (a) (4), intended to impose upon the bankruptcy court the unusual power and delicate duty of trying out afresh the facts found by the state with relation to the value of property. And there is no more reason to assume that Congress intended that the bankruptcy court should fail to give respect to an unappealed determination of value made by the Arkansas Corporation Commission."

The Circuit Court of Appeals below recognized that there is in the instant case a factual situation similar to that suggested by Mr. Justice Black for this Court in the just mentioned citation. It does not seem possible that anyone can seriously contend that, in the light of the litigation that has gone before concerning the 1932 to 1939 taxes, the petitioner can have any right to contest further the New Jersey tax assessments for such years in any court.

The Court below did not pass upon the several questions raised by the State concerning the nonapplicability of the several sections of the Bankruptcy Act with respect to the pre-existing tax liens of the State, nor did that Court pass upon the State's claim of immunity from suit. Just as this Court, in the *Arkansas Corporation Commission* case, said that it was unnecessary to determine the applicability of Section 64 to Section 77 proceedings, so did Judge McLaughlin in effect say that it was unnecessary to answer the objections to jurisdiction made by the State, for the reason that, conceding that all questions should be decided adversely to the said State, yet the Bankruptcy Court, under the facts and law of the instant case, only had power to review the assessments made by the State to determine whether or not there was mathematical error in computation. We agree with the Court below that the *Arkansas Corporation Commission* case would preclude any assumption of jurisdiction in a case such as ours. We respectfully urge however, that this Court said in the just mentioned case that any Federal questions involved would come to this Court by way of appeal from the State's highest court (pg. 144) and did not say that errors of law could be reviewed by the Bankruptcy Court in Section 77 proceedings where an adequate review is afforded in the State courts.

The Court below described in detail the steps provided by the New Jersey laws for a review of the tax assessments upon railroad properties. Because we are not forced to rely upon the adequacy of the State procedure in order to

substantiate our position in the instant case, but can properly rely upon the broad statement of principle expressed by this Court in the last mentioned citation having to do with fact that the Debtor has actually resorted to the State courts, we have not set out the details of the procedure for review afforded by the New Jersey Act, but are content with the statement of such procedure contained in the opinion below (R. pg. 158). (See also Appendix pg. 133.)

The State of New Jersey does maintain however that such procedure is wholly adequate. Such procedure has been in effect for many, many years. There have been many reviews by the New Jersey Courts of the taxing methods during such years. In *Central Railroad Company* vs. *Martin*, 114 N. J. L. 69, 73, the Supreme Court commented as follows (1934):

> "Thus notwithstanding that this contest has been waging for almost 50 years; and that almost every possible phase of this litigious question has been brought to our courts (It is estimated that it has been so brought in excess of 100 times) and received their consideration * * *."

It may not be said that the New Jersey procedure for review of railroad taxes has not been adequate. We urge that it has fully satisfied the rules of this Court concerning such adequacy of review.

We have made this last comment because of the fact that our procedure is by certiorari, which method of review was commented upon by this Court in *Hillsborough Township* vs. *Cromwell*, 66 S. Ct. 445 (1946). In that case this Court mentioned the denial of certiorari in *Lehigh Valley Railroad Company* vs. *State Board*, 174 A. 359, 12 N. J. Misc. 673. We wish to point out that, in the *Lehigh Valley Railroad* case, the Court was dealing with locally assessed

property used for other than railroad purposes. The action was directed against the assessments made by municipal authorities, who under no circumstances make assessments in cases where property is used for railroad purposes. The Court was not dealing with taxes assessed under the New Jersey Railroad Tax Act for which a separate certiorari procedure was established. R. S. 54:26-11 et seq.

As a matter of practical exposition, the method of review by certiorari has proved adequate because, in the 60 years during which the present method of procedure has been in operation, certiorari has never to our knowledge been denied in a case involving property in railroad use. We have shown above the great number of times the railroad tax controversy has been before our Courts. That was in 1934. Since then, notwithstanding that the railroad companies had resorted to the Federal courts and that those courts had held on two separate occasions that all federal questions concerning the taxing methods employed by the State of New Jersey had been made res judicata by *Central Railroad Company* vs. *Martin, supra,* the New Jersey Supreme Court again in 1942 granted its writ of certiorari upon the application of the trustees for review of the 1942 taxes in *Shelton Pitney and Walter P. Gardner* vs. *State Board,* 134 N. J. L. 34. Writs have been issued on application of the Trustees again in 1943 and 1944 and are awaiting argument.

It is respectfully urged that, even if this Court should hold that Section 64 does apply to Section 77 proceedings generally, yet it must be held that Congress did not intend under the facts of the instant case to confer jurisdiction upon the Bankruptcy Court to review the tax questions here presented (1) because of the litigation that has already gone before; and (2) because in any event the instant case is well within the rule of *Arkansas Corporation Commission* vs. *Thompson, supra,* in that as a matter of practical operation the review afforded by the State law is wholly adequate to afford the Petitioner the full protection of the law.

POINT IX.

Congress did not empower the Bankruptcy Court summarily to adjudicate in Section 77 proceedings concerning the constitutionality or the applicability of the Settlement Acts with respect to the taxes due the State of New Jersey under the facts of the instant case.

The Petitioner states in his brief (pg. 68) that he has tried "to make it crystal clear" that this case in no way involves any question as to the assessed value of the debtor's property. In short the debtor raises no question as to the amount and validity of the taxes, the only matters concerning taxes stated specifically by Congress to be the subject of review under Section 64.

Just when it became "crystal clear" is a matter of speculation. Not until December 27, 1945, over one month after the determination of the Court below, did the said Petitioner admit that he was affected by the judgment of the Circuit Court of Appeals in *Central Railroad* vs. *Martin*, 115 F. (2d) 968. See "Modifications of Supplemental and Amended Objections" which we have included in the appendix to this brief (pg. 149). And notwithstanding such admission as to the years 1934, 1935 and 1936, and notwithstanding what was said by the Circuit Court of Appeals to the effect that the several questions had become res judicata, we find nothing in that pleading which changes the picture concerning their contentions with reference to 1937, 1938 and 1939. Of course it has been crystal clear for a long time to all those but those who would not see that there has not been any debatable issue concerning the propriety of the assessments of the taxes which are the subject of this controversy since 1939. (100 F. (2d) 139.) The New Jersey Court of Errors and Appeals has commented upon the "illusory" nature of their asserted rights. The Bank-

ruptcy Court has stated with respect to similar tax litigation that there must be "a proscription of futility." (36 Fed. Sup. 156, 160.)

It necessarily follows that the only matters which the Petitioner could have contemplated reaching through the petition of August 14 were those incident to the passage of the Settlement Acts. The Petitioner has given no authority whatsoever to support the claimed power of the Bankruptcy Court to entertain summarily such questions even were they now before the federal courts de novo. The Bankruptcy Court in the light of the facts of the instant case is proscribed from undertaking a consideration of the matter because of what has gone before. We therefore respectfully urge that:

A. *The petitioner has pointed to no section of the Bankruptcy Act which grants to the Bankruptcy Court the power to review the questions presented by the Settlements Acts.*

Section 64 even were it applicable to Section 77 proceedings authorizes the Bankruptcy Court to review the amount and validity of taxes only. Where, as here, there is no question left open concerning amount or validity, it may not be said that the power to make the requested review might impliedly exist as an incident to the grant of the specific power. We respectfully urge that questions concerning the applicability of the Settlement Acts may not be considered summarily because of any authority contained in the said Section 64. We believe that the case of *Palmer* vs. *Massachusetts, supra,* is applicable here and that, in the absence of specific authority, it must be held that Congress did not intend to grant the power herein claimed by the Petitioner.

B. *The matter having heretofore been before the Federal Courts and action withheld pending a determination by the State Courts, the Federal Courts will not now entertain jurisdiction for the purpose of determining questions of State law incident to the said determination by the State Courts.*

The Petitioner, anxious to enjoy the benefits of the amended Settlement Acts, petitioned the Bankruptcy Court and obtained Order No. 163 fixing the liability of the Debtor at the amount prescribed by the Settlement Acts. The matter was appealed by the State to the Circuit Court of Appeals. On that appeal the several questions urged here were presented. The relationship of the contesting parties was urged. It was argued that the Debtor had fully complied and that there was a binding contract between the Debtor and the State under State law founded upon adequate consideration. The Circuit Court (*In re Central Railroad Co., supra,* 136 F. (2d) 633) disregarded all arguments and held that the Bankruptcy Court should have "in the exercise of a nice discretion" awaited the outcome of the State Court litigation, stating that:

> "For we are here concerned with the much larger issues as to the appropriate relationship between federal and state authorities functioning as a harmonious whole." (pg. 638.)

Citing *Chicago* vs. *Fieldcrest Dairies,* 316 U. S. 168; *Railroad Commission* vs. *Pullman Co.,* 312 U. S. 496. This Court denied certiorari 320 U. S. 805. In *Spector Motor Co.* vs. *McLaughlin,* 323 U. S. 101, this Court had a similar question before it. Mr. Justice Frankfurter said for this Court at page 105:

> "And so, as questions of federal constitutional powers have become more and more intertwined with preliminary doubts about local law, we have insisted that

federal courts do not decide questions of constitutionality on the basis of preliminary guesses regarding local law." Citing the *Pullman* case, the *Fieldcrest Dairy* case and our *Central Railroad* case.

There can be no doubt that the Circuit Court of Appeals intended to await the determination in *Wilentz* vs. *Hendrickson, supra.* There was only one case, one set of facts, one legislative act designed to relieve one group of people, who had collectively resisted the payment of their taxes. For the Federal Courts, in view of that determination, to undertake now to pass upon question of local law incident to that determination would be completely contrary to that sentiment so ably expressed above.

It must be remembered that this Court withheld determination in the *Spector* case in order to avoid, if possible, the necessity of determining Federal questions. We are not here concerned with such Federal questions. Can it be said that the Bankruptcy Court could with propriety now say that, as a matter of State law, the Settlement Acts are constitutional or that, as a matter of State law, the Treasurer must accept payment under the terms of the said Settlement Acts notwithstanding that a Chancery Court injunction permanently enjoins receipt of such payment?

The provisions of the Bankruptcy Act were never designed to permit the summary consideration by the Bankruptcy Court of matters such as those posed by the judgment of the New Jersey Court of Errors and Appeals concerning the unconstitutionality of the Settlement Acts. The Bankruptcy Court was therefore not authorized to undertake consideration of the matters presented by the petition of August 14th.

C. *In any event it is apparent that, since the only questions involved have to do with the alleged existence of a contract between the State and the Debtor, the petition of August 14th constitutes a suit against the State which may not be maintained without the State's consent.*

The Petitioner admits in his brief (pg. 69-70) that he seeks a determination of the validity of an asserted compromise with the State. We repeat what we have said above under sub-point VI-B concerning what constitutes a suit against the State. One need only read the first three prayers of the petition of August 14th to understand the nature of the present action. (R. pg. 62.) They do not seek to prevent an invasion of private rights by proceeding against the taxing officials as has been the case in a long line of decisions ever since *Osborn* vs. *Bank of the United States*, 22 U. S. 738 (1824), but instead the Trustee has proceeded directly against the State. We submit the petition of August 14th on its face constitutes a suit against the State and, since there had been no consent, the Bankruptcy Court is without jurisdiction to entertain the said petition.

In conclusion of this point, we respectfully urge that for the reasons above stated the Bankruptcy Court did not obtain jurisdiction to make in a summary manner the determinations sought by the petition of August 14th with respect to claimed rights under the terms of the Settlement Acts.

POINT X.

Regardless of the power of the Bankruptcy Court to undertake the consideration of the questions posed by the petition of August 14th, the Bankruptcy Court in the exercise of a nice discretion should refer the matters to the State Courts.

If all of the above questions are answered adversely to the State, nevertheless the Bankruptcy Court should not entertain jurisdiction in the instant case but should refer the matter to the State courts for determination.

We have shown that the Circuit Court of Appeals has already held that the Bankruptcy Court in the exercise of a nice discretion should not have considered the question of the constitutionality of the Settlement Acts. The matter having already been before the Bankruptcy Court, it became of even greater urgency that the said Bankruptcy Court should refuse to take jurisdiction to decide other questions of State law having to do with the constitutionality or applicability of the said Settlement Acts.

In this connection we call attention to the claim of the Petitioner that, under the law of the State of New Jersey, a person may acquire rights under an unconstitutional statute prior to the determination of unconstitutionality. Several cases are cited to support this contention at page 75 of Petitioner's brief. In *Allison* vs. *Corker* 67 N. J. L. 596 (E. & A. 1902), the Court was dealing with a formal defect in the legislative procedure. There was nothing inherently vicious in the subject matter of the Act. *Attorney General* vs. *McGuiness* 78 N. J. L. 346, (E. & A. 1910) had to do with the manner of adopting the Civil Service Act. The question was procedure. There was nothing inherently vicious in the subject matter of the Act. In *Eastwood* vs. *Russell* 81 N. J. L. 672 (E. & A. 1911) the Court was dealing with a defective title to an Act. There was

nothing vicious in the subject matter of the Act. *In re Public Utility Board* 83 N. J. L. 303 (S. Ct. 1912) likewise had to do with the title to an Act. There was nothing vicious in the subject matter of the Act.

But we are not concerned here with a matter of procedure. We are concerned with an Act purporting to do something inherently vicious—an Act purporting to make a gift to a corporation in direct violation of Article I, section 20 of the State Constitution which provides:

> "No donation of land or appropriation of money shall be made by the State or any municipal corporation to or for the use of any society, association, or corporation whatsoever."

If the Petitioner's contentions are upheld then the provision means nothing. Any legislature at any time could make a prohibited gift and, if the matter was consummated before the public became aware of what was going on, the gift would be constitutional. Not so easily may the Constitution be thwarted. As said by the Supreme Court concerning an Act inherently vicious in *Gimbel* vs. *Peabody, supra, 577*:

> "The argument that the prosecutor is in laches because large expenditures have been made are without merit. Those who can read can understand the constitutional provisions of this State, and if they choose to expend their money in defiance of the clear mandate of the people, they must take the consequences. Time may not inure to the advantage of those who choose to flout the Constitution of the State."

The Court of Errors and Appeals had the same statute before it in *Hyman* vs. *Long Branch Kennel Club* 115 N. J. L. 123 (1935). The Court below in that case had believed himself to be controlled by *Lang* vs. *Bayonne* 74 N. J. L. 455 and had held the Act to be effective prior to an adjudi-

cation of unconstitutionality notwithstanding, to use the words of the Court of Errors and Appeals (pg. 124):

> "that Judge Lawrence considered the Acts of 1933 and 1934 to be in flat defiance of the Constitution * * *."

The Court then said that the Acts were in flat defiance of the Constitution. It went on to hold that the *Lang* case did not embrace an Act the subject matter of which was in violation of the Constitution and that the Act in question was unconstitutional from the beginning. So that the law today in New Jersey is that an Act which violates the Constitution with respect to subject matter is void ab initio.

But even if the law were not so clear, nevertheless since the New Jersey Courts have already spoken as to the constitutionality of the Settlement Acts, the question of the time when their determination should take effect clearly comes within the rule of the *Spector* case and should be referred to the State Courts. This is particularly so in the instant case by reason of the fact that the fiscal officers of the State are permanently enjoined from accepting any payment pursuant to the terms of the said Settlement Acts.

In the *Spector Motor Co.* vs. *McLaughlin, supra,* case, this Court of its own motion held that matters of local law should be not decided by the Federal courts. This Court said (pg. 105):

> "If there is one doctrine more deeply rooted than any other in the process of constitutional adjudication, it is that we ought not to pass on questions of constitutionality—here the distribution of the taxing power as between the State and the Nation—unless such adjudication is unavoidable. And so, as questions of federal constitutional power have become more and more intertwined with preliminary doubts about local law, we

have insisted that federal courts do not decide questions of constitutionality on the basis of preliminary guesses regarding local law. (Citing cases.) Avoidance of such guesswork, by holding the litigation in the federal courts until definite determinations on local law are made by the state courts, merely heeds this time-honored canon of constitutional adjudication."

See also *Thompson* vs. *Magnolia Petroleum Co.*, 309 U. S., 478 (1939).

We respectfully urge that under no circumstances should the Bankruptcy Court have undertaken consideration of the petition of August 14th but, even though there otherwise might be jurisdiction, the questions presented by such petition having to do with the constitutionality of the Settlement Acts should have been referred to the State courts.

POINT XI.

The petitioner had ample time to intervene in the State Court proceedings.

We pointed out above that the Circuit Court of Appeals reversed Order No. 163 on May 27, 1943, which was prior to the Chancery Court's determination in *Wilentz* vs. *Hendrickson*, 133 N. J. Eq. 447, and more than one year prior to the final determination by the Court of Errors and Appeals in that case.

The Petitioner knew that the matter was before the State Courts. He knew those Courts were dealing with one question, involving one set of facts and one group of companies who had concertedly resisted payment of taxes.

With full knowledge of the Circuit Court's views concerning the appropriate relationship that should exist between the Federal and State authorities functioning as a

harmonious whole, the petitioner elected to do nothing. It did not intervene in the State proceedings notwithstanding they were being prosecuted by the State's highest legal officer.

Courts of bankruptcy are essentially Courts of equity. *Pepper* vs. *Litton, supra; Prudence Realization Corp.* vs. *Geist, supra.* Equity aids the vigilant. *Waller* vs. *Texas R. Co.*, 245 U. S. 398 (1918). *Baker* vs. *Cummings*, 169 U. S. 189 (1898). The Petitioner in the instant case did not display that vigilance that would give him a standing before this Court to claim equity. He preferred instead to await the outcome of the litigation in the State Courts without his intervention, thus to be in a position to claim the benefits if the results were favorable—to deny its applicability if it should be adverse. We respectfully urge that the petitioner was in laches and having bided his time while the New Jersey courts rendered the decisions in the said *Wilentz* vs. *Hendrickson* case, *supra*, may not be heard to say that the questions contained in that case are still open.

CONCLUSION.

For the reasons set forth above it is respectfully submitted that the judgment of the Circuit Court of Appeals reversing Order No. 271 should be affirmed.

Respectfully submitted,

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APPENDIX.

Pertinent Sections of the New Jersey Tax Act under which the 1932 to 1939 taxes were assessed.

R. S. 54:20–1:

"All the property of a railroad or canal company not used for railroad or canal purposes shall be assessed and taxed by the same assessors, in the same manner and at the same rate as the taxable property of other owners in the same taxing district."

R. S. 54:20–2:

"All property of a railroad or canal company used for railroad or canal purposes shall be assessed and taxed by the state tax commissioner in the manner provided in chapters 19 to 29 of this title (§ 54:19–1 et seq.), and the tax so imposed shall be in lieu of all other taxation upon property so subject to taxation."

R. S. 54:22–1:

"The state tax commissioner shall sit at Trenton on the first Tuesday of March in each year, and as often during the year and at such places as his duties may require for the purpose of ascertaining the true value, as of the first day of January preceding, of all property used for railroad or canal purposes of each railroad and of each canal company in this state, including its franchises, and he shall, in such ascertainment, ascertain:

I. The length and value of the main stem of each railroad, and of the waterway of each canal and the length of such main stem and waterway in each taxing district;

II. The value of the other real estate used for railroad or canal purposes in each taxing district in this state, including the roadbed (other than main stem), waterways, reservoirs, tracks, buildings, water tanks, waterworks, riparian rights, docks, wharves and piers, and all other real estate, except lands not used for railroad or canal purposes;

III. The value of all the tangible personal property of each railroad and of each canal company;

IV. The value of the remaining property, including the franchise. The commissioner shall complete his valuations by the first day of November following and on or before December tenth next following he shall serve upon the treasurer of each railroad and canal company or leave at his office a statement of the assessed valuation of the property of such company in the state and of the separate valuation of the property of such company in each taxing district."

R. S. 54:23-1:

"On or before March first in each year, every company running, operating or constructing a railroad or canal in this state shall return to the state tax commissioner statements or schedules showing its property as it existed on the first day of January preceding. The statement shall show: * * *"

R. S. 54:23-4:

"If a person or corporation running, operating or constructing a railroad or canal shall willfully neglect to make returns as required by this chapter, he or it shall forfeit as a penalty not more than ten thousand dollars for each offense, to be assessed by the jury. The penalty shall be recovered by an action at law in the supreme court brought in the name of the state and shall be paid into the state treasury. The state tax commis-

sioner shall certify any such default to the attorney general, who shall prosecute the action for the penalty."

R. S. 54:24–11:

"The entire amount of tax derived from the assessment of property described in subdivision II of section 54:22–1 of this title shall be allotted to and paid over to the local taxing districts through which the railroads or canals run, giving to each district the total amount of tax that may be so derived from such property of each railroad or canal company therein."

R. S. 54:26–1:

"On the first Monday of July after the filing of the returns the commissioner shall sit at the state house in Trenton, and shall give a hearing to all companies interested, touching the valuation and assessment of their property. He may adjourn from day to day, and may, if he sees fit, require all arguments and communications to be presented in writing. When the first Monday in July shall fall on the fourth or fifth day of the month, the meeting shall be held on the first Tuesday of July. All parties interested shall take notice of this hearing."

R. S. 54:26–2:

"The state tax commissioner shall sit on the second Monday of January in each year at the state house, Trenton, for the purpose of reviewing his assessments under chapters 19 to 29 of this title (§ 54:19–1 et seq.), made as of January first of the previous year, and may adjourn from time to time till he shall have finished the hearings."

R. S. 54:26-7:

"Any railroad or canal company or the attorney general on behalf of the state or, in respect to second-class property, the authorities of the taxing district, desiring to contest the final determination of the state tax commissioner under sections 54:26-2 to 54:26-5 of this title, or the validity or amount of the tax levied under chapters 19 to 29 of this title (§ 54:19-1 et seq.), or any railroad or canal company or the attorney general on behalf of the State and of the taxing districts claiming that there has been illegal discrimination in the assessment of any property or in the levying or imposing of the tax thereon under said chapters 19 to 29, or that there has been illegal discrimination in the assessment of property under said chapters 19 to 29 as compared with the assessment of property generally under chapter 4 of this title (§ 54:4-1 et seq.), may, on or before the third Monday of June following the levying or imposing of the tax, file a written complaint with the state board of tax appeals, specifying the grounds of complaint and the relief sought, which shall be in such form and contain such further information as may be from time to time prescribed by the rules of the state board of tax appeals for the better understanding and determination of the complaint."

R. S. 54:26-11:

"If a railroad or canal company, or, the attorney general on behalf of the state or, in respect to second-class property, if the authorities of any taxing district shall desire to contest the final determination of the state board of tax appeals, such contest shall be made by certiorari, provided the application therefor shall be made within three months from the date of the certification to the state tax commissioner of the final determination of the state board of tax appeals."

R. S. 54:27-1:

"The state tax commissioner shall certify and report to the comptroller on or before the first day of June following his completion of valuations, and within ten days thereafter serve upon the treasurer of each company or leave at his office, a statement of the assessed valuation of the property of such company in the state, and of the separate valuation of property in each taxing district, as made by him, the amount of tax payable by such company with respect to its property separately valued in each taxing district, the aggregate assessed valuation and the total tax levied upon each company. The statement shall be made separately for each company, and as to the property separately valued, shall be arranged by taxing districts in such manner as to be of easy reference, and shall be recorded in books in the office of the state comptroller, to be provided by him for that purpose, and shall be public records subject to public inspection. The failure to serve the notice herein required upon the company shall not invalidate any tax assessed or affect any lien created by chapters 19 to 29 of this title (§ 54:19-1 et seq.)."

R. S. 54:27-2:

"The amount of tax payable by each company, as shown by the statement, shall be due and payable into the state treasury on any day between said June first and December first following. All payments shall be made to the state treasurer."

R. S. 54:27-4:

"If the taxes of any company, or any portion thereof, remain unpaid on December first following the levying thereof, the company shall be considered in default, and such taxes, or the unpaid portion thereof, shall

thenceforth bear interest at the rate of one per cent for each month until paid, notwithstanding the prosecution of a writ of certiorari or other remedy. These taxes shall be a lien paramount to all other liens upon all the lands and tangible property and franchises of the company in this state. The lien shall take effect on June first of the year in which the tax is payable and shall be a debt due from the company to the state on that date for which an action at law or suit in equity may be maintained, and shall be a preferred debt in case of insolvency. These remedies are in addition to the special proceedings provided for in chapters 19 to 29 of this title (§ 54:19–1 et seq.)."

R. S. 54:27–6:

"If a company shall be in default under chapters 19 to 29 of this title (§ 54:19–1 et seq.), in the payment of the state tax aforesaid, a person having an interest in a mortgage or other lien on its franchises or property, may pay the state treasurer the amount of such state tax and the interest due thereon, and receive from the treasurer a certificate of such payment. He shall thereupon be entitled to be repaid the amount of the tax and interest thereon at the rate of twelve per cent per annum out of the first proceeds of any sale of the franchises or property of the company, and the tax and interest thereon shall continue a lien on the franchise and property of the company for the benefit of the holder of or person interested in the mortgage or lien until paid by the company from the sale of its franchises or property. If proceedings have been taken by the attorney general to enforce the payment of the tax and interest thereon, the holder of or person interested in a mortgage or lien paying the tax and interest shall pay such additional amount as a justice of the supreme court shall certify to be proper and reasonable for the

expenses and services of the proceedings as far as they have progressed for the collection of the tax and interest thereon."

R. S. 54:27-7:

"Any railroad or canal company against which a tax has been or shall be levied may pay the same into the state treasury, notwithstanding litigation may be pending as to the validity of the whole or any part of said tax, and if it shall be determined in any litigation that the whole or any part of the tax so paid has been unlawfully assessed or imposed, the state treasurer shall give credit for such overpayment to the corporation so paying, upon the taxes next legally levied and payable into the state treasury subsequent to the determination of any such litigation."

R. S. 54:28-1:

"If a tax levied and assessed under the provisions of chapters 19 to 29 of this title (§ 54:19-1 et seq.) shall remain unpaid in whole or in part for ten days after the expiration of the time limited for the payment thereof, the attorney general shall apply forthwith to a justice of the supreme court for an order that the tax together with the interest due thereon and a reasonable sum to be certified by the justice to be paid for the expense of the proceeding, shall be made a record of the supreme court, and judgment shall be entered therefor in the name of the state as plaintiff against the company and the mortgagee or other creditor, as defendants. The order shall be made upon the production of a certified copy from the comptroller of the certificate and report of the state tax commissioner on file in his office, and of the certificate of the comptroller that the tax has not been paid."

R. S. 54:28–2:

"The attorney general shall apply for an order that execution forthwith issue on the judgment, directed to a master of the court of chancery, to be named by the justice in the order."

R. S. 54:28–4:

"If a certiorari shall have been allowed, on application of the attorney general the orders referred to in sections 54:28–1 and 54:28–2 of this title shall be made and enforced without prejudice to the right of the state to enforce the payment of any additional amount of tax which may be imposed and to apply for a second judgment therefor. If a certiorari shall have been allowed on application of a company or mortgagee or other creditor taxed and the tax shall have been reduced after the payment thereof, the excess shall be repaid by the state upon the order of the court, and the state comptroller shall, upon such order, issue his warrant for such payment accordingly."

R. S. 54:28–5:

"The master in chancery to whom the execution shall be directed shall sell all the franchise, real estate and rolling stock and property of the company, the estate and interest of any mortgagee and the debt due to any creditor for which a deduction has been allowed, or so much thereof as may be necessary to make the amount due on the tax judgment and usual execution fees. The execution shall describe the property or debt aforesaid whereon the tax was assessed, and shall direct the sale thereof, and, generally, the sale of all other property of the company or person. The sale shall pass the absolute title to the franchise and property and debt aforesaid so sold, on which the tax was assessed or became a lien, free and clear of all liens,

encumbrances and trusts of every nature, except taxes subsequently levied. In case of the sale of the estate and interest of a mortgagee it shall pass as well such estate as the interest of all bondholders and cestuis que trustent for whose benefit the mortgage may have been given or may be held in trust or otherwise. As to any other property of the company or persons, the judgment and execution shall constitute or become liens in the same manner and to the same extent as other judgments and executions of the supreme court. The sale, advertisements and proceedings under such executions shall be the same as under other executions of the supreme court."

Present New Jersey Tax Act.

R. S. 54:29A–74:

"All other State and local taxes of or upon franchises or property used for railroad purposes, which may have been assessed for the first year in which this act becomes effective upon any taxpayer subject to taxation hereunder prior to the enactment of this act, shall abate and be canceled of record as of the effective date hereof. This act shall be construed as a revision of chapters nineteen through twenty-nine, inclusive, of Title 54 of the Revised Statutes, and nothing herein shall be construed to affect any pending litigation, nor to repeal, abate, cancel, cause to lapse or otherwise affect in any manner any assessment or the lien or obligation to pay any taxes heretofore assessed to any taxpayer, or the legal authority to collect taxes, interest and penalties which have accrued under any provision of law repealed by this act, or under any other law, except as specifically provided in this act, or to affect the right of the State Tax Commissioner to assess omitted property, and apportion the tax so assessed, for any year prior to one thousand nine hundred and

forty-one, according to the classifications and at the rates prescribed in the chapters aforesaid. Nor shall this act affect in any manner any distribution allotment or apportionment of tax receipts made or required to be made under any provision of law repealed by this act."

Pertinent Sections of the Bankruptcy Act.

Section 17 (11 U. S. C. A. Sect. 35) in part:

"a. A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as (1) are due as a tax levied by the United States, or any State, county, district, or municipality;"

Section 57 (11 U. S. C. A. Sect. 93) in part:

"(e) Claims of secured creditors and those who have priority may be temporarily allowed to enable such creditors to participate in the proceedings at creditors' meetings held prior to the determination of the value of their securities or priorities, but shall be thus temporarily allowed for such sums only as to the courts seem to be owing over and above the value of their securities or priorities.

(j) Debts owing to the United States or any State or subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law.

(n) Except as otherwise provided in this title, all claims provable under this title, including all claims of the United States and of any State or subdivision thereof, shall be proved and filed in the manner pro-

vided in this section. Claims which are not filed within six months after the first date set for the first meeting of creditors shall not be allowed: *Provided, however,* That the court may, upon application before the expiration of such period and for cause shown, grant a reasonable fixed extension of time for the filing of claims by the United States or any State or subdivision thereof: * * *"

Section 64 (11 U. S. C. A. Sect. 104) in part:

"a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the filing fees paid by creditors in involuntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, shall have been recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of such recovery; the costs and expenses of administration, including the trustee's expenses in opposing the bankrupt's discharge, the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases and to the bankrupt in voluntary and involuntary cases, as the court may allow; (2) wages, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether

or not selling exclusively for the bankrupt; * * * (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof: *Provided,* That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court: *And provided further,* That, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court:"

Section 67 (11 U. S. C. A. Sect. 107) in part:

"b. The provisions of section 96 of this title to the contrary notwithstanding, statutory liens in favor of employees, contractors, mechanics, landlords, or other classes of persons, and statutory liens for taxes and debts owing to the United States or any State or subdivision thereof, created or recognized by the laws of the United States or of any State, may be valid against the trustee, even though arising or perfected while the debtor is insolvent and within four months prior to the filing of the petition in bankruptcy or of the original petition under chapter 10, 11, 12, or 13 of this title, by or against him. Where by such laws such liens are required to be perfected and arise but are not perfected before bankruptcy, they may nevertheless be valid, if perfected within the time permitted by and in accordance with the requirements of such laws, except that if such laws require the liens to be perfected by the seizure of property, they shall instead be perfected by filing notice thereof with the court.

c. Where not enforced by sale before the filing of a petition in bankruptcy or of an original petition under chapter 10, 11, 12, or 13 of this title, though valid under subdivision b of this section, statutory liens, including liens for taxes or debts owing to the United States or

to any State or subdivision thereof, on personal property not accompanied by possession of such property, and liens whether statutory or not, or distress for rent shall be postponed in payment to the debts specified in clauses (1) and (2) of subdivision a of section 104 of this title, and, except as against other liens, such liens for wages or for rent shall be restricted in the amount of their payment to the same extent as provided for wages and rent respectively in subdivision a of section 104 of this title."

Section 77 (11 U. S. C. A. Sect. 205) in part:

"(a) * * * Process of the court shall extend to and be valid when served in any judicial district. The Supreme Court of the United States shall promulgate rules relating to the service of process outside of the district in which the proceeding is pending, and any other rules which it may deem advisable in order to aid district courts and circuit courts of appeal in exercising the jurisdiction herein conferred upon them * * * (b) A plan of reorganization within the meaning of this section (1) shall include provisions modifying or altering the rights of creditors generally, or of any class of them, secured or unsecured, either through the issuance of new securities of any character or otherwise; * * * The term 'securities' shall include evidences of indebtedness either secured or unsecured, bonds, stock, certificates of beneficial interest therein, certificates of beneficial interest in property, options, and warrants to receive, or to subscribe for, securities. The term 'stockholders' shall include the holders of voting-trust certificates. The term 'creditors' shall include, for all purposes of this section all holders of claims of whatever character against the debtor or its property, whether or not such claims would otherwise constitute provable claims under this

Act, including the holder of a claim under a contract executory in whole or in part including an unexpired lease.'

The term 'claims' includes debts, whether liquidated or unliquidated, securities (other than stock and option warrants to subscribe to stock), liens, or other interests of whatever character. For all purposes of this section unsecured claims, which would have been entitled to priority if a receiver in equity of the property of the debtor had been appointed by a Federal court on the day of the approval of the petition, shall be entitled to such priority and the holders of such claims shall be treated as a separate class or classes of creditors. * * * (c) * * * (2) * * * Prior to the appointment of a trustee, the debtor on behalf of the court shall continue in the possession of the property and shall operate the business thereof during such period, and shall have all the title to the property and shall exercise all power consistent with the provisions of this section, subject at all times to the control of the judge, and to such limitations, restrictions, terms, and conditions as he may from time to time impose and prescribe. * * * (e) * * * "If the United States of America, or any agency thereof, or any corporation (other than the Reconstruction Finance Corporation) the majority of the stock of which is owned by the United States of America, is a creditor or stockholder, the interests or claims thereof shall be deemed to be affected by the plan, and the President of the United States, or any officer or agency he may designate, is hereby authorized to act in respect of the interests or claims of the United States or of such agency or other corporation. The expense of such submission shall be certified by the Commission and shall be borne by the debtor's estate. The Commission shall certify to the judge the results of such submission. * * * *Provided*

further, That if, in any reorganization proceeding under this section, the United States is a creditor on claims for taxes or customs duties (whether or not the United States has any other interest in, or claim against, the debtor, as creditor or stockholder), no plan which does not provide for the payment thereof shall be confirmed by the judge except upon the acceptance, certified to the court, of a lesser amount by the President of the United States or the officer or agency designated by him pursuant to the provisions of the preceding paragraph hereof: *Provided further*, That if the President of the United States or such officer or agency shall fail to accept or reject such lesser amount for more than ninety days after receipt of written notice so to do from the court, accompanied by a certified copy of the plan, the consent of the United States insofar as its claims for taxes or customs duties are concerned shall be conclusively presumed."

11 U. S. C. A. Sect. 506, in part:

"(1) 'claims' shall include all claims of whatever character against a debtor or its property, except stock, whether or not such claims are provable under section 103 of this title and whether secured or unsecured, liquidated or unliquidated, fixed or contingent; • • •

(4) 'creditor' shall mean the holder of any claim;

(5) 'debtor' shall mean a corporation by or against which a petition has been filed under this chapter;

(6) 'debts' shall include all claims; • • • "

11 U. S. C. A. Sect. 599:

"If the United States is a secured or unsecured creditor or stockholder of a debtor, the claims or stock thereof shall be deemed to be affected by a plan under this chapter, and the Secretary of the Treasury is hereby authorized to accept or reject a plan in respect of the claims or stock of the United States. If, in any

proceeding under this chapter, the United States is a secured or unsecured creditor on claims for taxes or customs duties (whether or not the United States has any other interest in, or claim against the debtor, as secured or unsecured creditor or stockholder), no plan which does not provide for the payment thereof shall be confirmed by the judge except upon the acceptance of a lesser amount by the Secretary of the Treasury certified to the court: *Provided*, That if the Secretary of the Treasury shall fail to accept or reject a plan for more than ninety days after receipt of written notice so to do from the court to which the plan has been proposed, accompanied by a certified copy of the plan, his consent shall be conclusively presumed. July 1, 1898, c. 541, § 199, as added June 22, 1938, c. 575, § 1, 52 Stat. 893."

California Constitution, Article XII, Section 13:

"[Loan of state credit] The State shall not in any manner loan its credit, nor shall it subscribe to, or be interested in the stock of any company, association, or corporation."

New Jersey Constitution, Article I, Paragraph 19:

"[Loan of local credit] No county, city, borough, town, township or village shall hereafter give any money or property, or loan its money or credit, to or in aid of any individual, association or corporation, or become security for, or be directly or indirectly the owner of, any stock or bonds of any association or corporation."

Article IV, Section VI, Paragraph 3:

"[Loan of state credit] The credit of the State shall not be directly or indirectly loaned in any case."

Ohio Constitution, Article VIII, Section 4:

"[Loan of state credit] The credit of the State shall not, in any manner, be given or loaned to, or in aid of,

any individual, association or corporation whatever; nor shall the State ever hereafter become a joint owner, or stockholder, in any company or association in this State, or elsewhere, formed for any purpose whatever."

Article VIII, Section 6:

"[Loan of municipal credit] No laws shall be passed authorizing any county, city, town or township, by vote of its citizens, or otherwise, to become a stockholder in any joint stock company, corporation, or association whatever; or to raise money for, or to loan its credit to, or in aid of, any such company, corporation, or association: provided, that nothing in this section shall prevent the insuring of public buildings or property in mutual insurance associations or companies. Laws may be passed providing for the regulation of all rates charged or to be charged by any insurance company, corporation or association organized under the laws of this State or doing any insurance business in this State for profit."

Pennsylvania Constitution, Article IX, Section 6:

"[Loan of state credit] The credit of the Commonwealth shall not be pledged or loaned to any individual, company, corporation or association, nor shall the Commonwealth become a joint owner or stockholder in any company, association or corporation."

Article IX, Section 7:

"[Loan of local credit] The General Assembly shall not authorize any county, city, borough, township or incorporated district to become a stockholder in any company, association or corporation, or to obtain or appropriate money for, or to loan its credit to, any corporation, association, institution or individual."

Appendix

Mandate of the Circuit Court of Appeals in *Central Railroad Company* vs. *Martin*, 115 F. (2d) 968.

"UNITED STATES OF AMERICA, *ss:*

THE PRESIDENT OF THE UNITED STATES OF AMERICA,

To the Honorable the Judges of the District
[SEAL] *Court of the United States for the District of New Jersey*

GREETING:

WHEREAS, lately in the District Court of the United States for the District of New Jersey, before you or some of you, in a cause between Central Railroad Company of New Jersey, plaintiffs below (appellee) and J. H. Thayer Martin, State Tax Commissioner of the State of New Jersey; Frank J. Murray, Comptroller of the State of New Jersey; William H. Albright, Treasurer of the State of New Jersey, and David T. Wilentz, Attorney-General of the State of New Jersey, defendants below (appellants)—No. 5184-1934—a judgment was entered in the said District Court on January 25, 1940, which judgment is of record in the office of the Clerk of said District Court, to which reference is hereby made, and the same is hereby expressly made a part hereof as by the inspection of the transcript of the record of the said District Court, which was brought into the United States Circuit Court of Appeals for the Third Circuit by virtue of an appeal by defendants agreeably to the Act of Congress, in such case made and provided, more fully and at large appears.

AND WHEREAS, in the present term of October, in the year of our Lord one thousand nine hundred and forty, the said cause came on to be heard before the said United States Circuit Court of Appeals on the said transcript of record and was argued by counsel:

ON CONSIDERATION WHEREOF, it is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby reversed, with costs, and the cause is remanded to the said District Court with directions to dismiss the action. And that the said Appellants, J. H. Thayer Martin, State Tax Commissioner of the State of New Jersey; Frank J. Murray, Comptroller of the State of New Jersey; William H. Albright, Treasurer of the State of New Jersey; and David T. Wilentz, Attorney-General of the State of New Jersey, recover against the said Appellee, The Central Railroad Company of N. J., in the sum of

EIGHTY and 35/100 DOLLARS ($80.35)

for their costs herein expended, and have execution therefor.

Philadelphia,
November 27, 1940.

You, therefore, are hereby commanded that such execution and further proceeding be had in said cause, as according to right and justice, and the laws of the United States, ought to be had, the said appeal notwithstanding.

WITNESS, the Honorable CHARLES EVANS HUGHES, Chief Justice of the Supreme Court of the United States, at Philadelphia, the 12th day of May, in the year of our Lord one thousand and nine hundred and forty-one.

COSTS OF Appellants, J. H. Thayer Martin, etc., et al.

Clerk	$60.35
Printing Record ...	$
Attorney	$20.00
	$80.35

WM. P. ROWLAND,
Clerk of the U. S. Circuit Court of Appeals, Third Circuit."

Appendix

Modification of Supplemental and Amended Objections and Defenses of Debtor's Trustees to Claims filed by the State of New Jersey.

"IN THE

DISTRICT COURT OF THE UNITED STATES
FOR THE DISTRICT OF NEW JERSEY

In the Matter of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, *Debtor.*	In Proceedings for the Reorganization of a Railroad. No. 29778.

Modification of Supplemental and Amended Objections and Defenses of Debtor's Trustees to Claims filed by the State of New Jersey.

Honorable Augustus C. Studer, Jr., Special Master, United States District Court:

DEAR SIR:

1. Prior to and at the time of the filing of the petition in bankruptcy herein the Debtor had contested and was contesting in this Court, sitting as a court of equity, the tax assessments that had been entered against it under the Railroad Tax Act of the State of New Jersey in and for each of the tax years 1934, 1935 and 1936.

2. The Court enjoined the collection of more than 70% of the taxes levied upon the basis of each of said assessments for the years 1934, 1935 and 1936 until the taxing authorities of New Jersey should make new assessments according to law. *Central R. Co. of New Jersey* vs. *Martin*, 30 F. Supp. 41.

3. On appeal the United States Circuit Court of Appeals for the Third Circuit reversed said injunctive decree and

remanded with directions to the District Court to dismiss the actions. *Central R. Co. of New Jersey* vs. *Martin*, 115 F. (2d) 968.

4. The mandates of the Circuit Court in said actions were issued to this Court on May 12, 1941.

5. On November 15, 1945, said Circuit Court filed its opinion in Cases No. 8861 and 8889, the latter of which was an appeal from Order No. 271 of this bankruptcy court in these proceedings. The Circuit Court has deferred the issuance of its mandates in said cases pending consideration on the part of the undersigned Trustees as to the necessity and advisability of an application for rehearing, clarification or other relief touching various matters contained in said opinion bearing on those defenses pleaded in the alternative by the Trustees with respect to the claims of the State of New Jersey for the years subsequent to 1936. However, entirely apart from the foregoing considerations, it is evident from said opinion of November 15, 1945, that the mandates of the Circuit Court of Appeals issued as aforesaid on May 12, 1941, were intended to govern and control the liability of the Debtor's estate to the State of New Jersey for the principal of the taxes levied against the Debtor for the years 1934, 1935 and 1936. Accordingly, the undersigned Trustees of the Debtor hereby amend Paragraph 5 of their Supplemental Objections, filed herein on November 22, 1944, so as to eliminate from said Paragraph 5 all references to the years 1934, 1935 and 1936 and the related amounts.

SHELTON PITNEY and WALTER P. GARDNER,

Trustees of the property of The Central Railroad Company of New Jersey, Debtor,

By /s/ SHELTON PITNEY,

SHELTON PITNEY,

Trustee."

Dated: December 27, 1945.

Appendix

IN THE

DISTRICT COURT OF THE UNITED STATES

FOR THE DISTRICT OF NEW JERSEY

In the Matter of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, *Debtor.*	In Proceedings for the Reorganization of a Railroad. No. 29778.

Petition of Trustees for Order No. 303 Authorizing Them to Pay Balances Claimed by the State of New Jersey on Account of 1941 Taxes.

To the Honorable Guy L. Fake, Judge of the District Court of the United States for the District of New Jersey:

The petition of Shelton Pitney and Walter P. Gardner, as Trustees of the property of The Central Railroad Company of New Jersey, Debtor, respectfully shows:

1. On or about May 31, 1941 the State Tax Commissioner of the State of New Jersey assessed against your petitioners as Trustees of the Debtor an *ad valorem* tax of $3,369,759.34 for the tax year 1941. In assessing said tax the Commissioner acted under the provisions of the Railroad Tax Act then in force, viz., R.S.N.J. 54:19–1 *et seq.*

2. On June 16, 1941 your petitioners appealed from said assessment of $3,369,759.34 to the State Board of Tax Appeals, pursuant to and as authorized by R.S.N.J. 54:26–7.

3. On August 11, 1941 your petitioners waived said appeal and all right of appeal from said assessment pur-

suant to Order No. 123 in this cause and the provisions of Chapter 290 of the Laws of New Jersey of 1941 which required any railway taxpayer electing to comply with said Chapter to waive "any and all rights to contest the legality or amount of any assessment made prior to December first, one thousand nine hundred and forty-one" (L. 1941, c. 290, p. 771, Sec. 8).

4. On or about November 5, 1941, pursuant to the Railroad Tax Law of 1941 (L. 1941, c. 291, p. 773), the State Tax Commissioner re-computed and re-assessed petitioners' 1941 *ad valorem* tax at $2,010,218.76. On December 1, 1941 your petitioners duly paid to the State said tax of $2,010,218.76. On June 15, 1942 your petitioners also paid to the State a 1941 franchise tax of $239,749.80, which was assessed by the State on or about May 21, 1942 pursuant to Chapter 169 of the Laws of New Jersey of 1942 (L. 1942, c. 169, p. 513), and filed the further or additional waiver and other documents required by Chapter 241 of the Laws of New Jersey of 1942 (L. 1942, c. 241, pp. 656-7, secs. 8 and 9).

5. On August 29, 1945 the New Jersey Supreme Court filed an opinion in certain cases argued on January 19, 1944 entitled "*City of Jersey City* v. *State Board of Tax Appeals et al.*" (not yet reported). Said opinion holds, in substance, that the Railroad Tax Law of 1941 was unconstitutional with respect to the tax year 1941, in that it violated Paragraph 20 of Article I of the Constitution of the State of New Jersey by reducing the amount of the 1941 railroad taxes as originally assessed under R.S.N.J. 54:19–1 *et seq.* at the "average tax rate" of $4.818 on each $100 of valuation, through the substitution of a 3% tax rate. A rule for judgment was entered on said opinion on October 16, 1945 which provided "that all of the assessments of property and franchise excise taxes made by the State Tax Commissioner for the year 1941, under the Railroad Tax Law of 1941 (Chapter 291, as amended by

Chapter 169 of the Laws of 1942), are null and void, and that the same be and they herewith are set aside and for nothing holden" and "that all of the assessments of railroad property made by the State Tax Commissioner for the year 1941, under and pursuant to the Revised Statutes of 1937, are, and have been since the making thereof, valid, lawful and subsisting obligations of the taxpayers assessed", but "subject to credit in favor of such taxpayers against said obligations for any sums paid on account of property or franchise excise tax assessments purportedly made for the year 1941 under and pursuant to the Railroad Tax Law of 1941 (Chapter 291, as amended by Chapter 169 of the Laws of 1942)".

6. Petitioners show that said decision and rule for judgment purport to reinstate said original 1941 tax assessment of $3,369,759.34, with credit for the taxes billed and paid as aforesaid. The State of New Jersey claims on the basis of said decision that the unpaid portion of said original 1941 tax assessment became "due" on December 1, 1941 and was thereafter "delinquent" and therefore has been and is bearing interest at the rate of 1% per month computed from said date (L. 1941, c. 291, p. 791, Sec. 53).

7. Petitioners show that if they do not now pay to the State the balance claimed by it on account of the 1941 *ad valorem* tax as originally assessed, with interest at the statutory rate of 1% per month from December 1, 1941, unless said decision and rule for judgment are reversed by the Court of Errors and Appeals, it may be contended that interest has continued to accrue on said balance at said rate and that petitioners have contested the amount or validity of said original assessment on its merits in contravention of their aforementioned waivers, the requirements of the statute (L. 1942, c. 241, p. 655, Sec. 6; L. 1941, c. 290, p. 771, Sec. 8), and the orders of this Court under which they so waived.

8. Your petitioners are confronted with a similar problem in respect of each of two subsidiary companies of the Debtor, viz., The Ogden Mine Railroad Company and The Dover & Rockaway Railroad Company, and for the reasons hereinabove explained petitioners must now pay smaller balances similarly claimed by the State on account of 1941 *ad valorem* taxes as originally assessed to your petitioners in respect of the railroad properties of said subsidiary companies.

Your petitioners therefore pray for the aid and instructions of this Court in the premises and for authority to make payment of said alleged unpaid balances of the 1941 tax assessments as originally levied against your petitioners in respect of the railroad properties of the Debtor, said The Ogden Mine Railroad Company and said The Dover & Rockaway Railroad Company, together with interest thereon at the rate of 1% per month from December 1, 1941, without prejudice, however, to petitioners' right under the provisions of Section 49 of Chapter 291 of the Laws of New Jersey of 1941 (L. 1941, p. 790) to have credited said principal and interest on account of any future taxes that may be due to the State of New Jersey, or their right to other redress, in the event the Court of Errors and Appeals reverses said decision and rule for judgment; and that your petitioners may be further authorized to take all such other, further and incidental steps as may be necessary to protect the Debtor's estate in the premises.

And your petitioners will ever pray, etc.

SHELTON PITNEY
WALTER P. GARDNER
As Trustees of the property of
The Central Railroad Company
of New Jersey,
By SHELTON PITNEY

Dated: November 14, 1945.
Filed: November 14, 1945.

(Verification dated November 14, 1945 omitted in printing.)

Appendix

IN THE

DISTRICT COURT OF THE UNITED STATES

FOR THE DISTRICT OF NEW JERSEY

In the Matter of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, *Debtor.*	In Proceedings for the Reorganization of a Railroad. No. 29778.

Order No. 303, Authorizing Trustees to Pay Balances Claimed by the State of New Jersey on Account of 1941 Taxes.

Upon reading and filing the petition of the Trustees, duly verified on the 14th day of November, 1945, touching the claims of the State of New Jersey for unpaid balances of the 1941 tax assessments as originally levied against the Trustees in respect of the railroad properties of the Debtor, The Ogden Mine Railroad Company and The Dover & Rockaway Railroad Company, said claims being founded upon an opinion filed by the New Jersey Supreme Court on August 29, 1945 and rule for judgment entered thereon on October 16, 1945, in certain cases entitled *"City of Jersey City* vs. *State Board of Tax Appeals, et al."*; and it appearing to the Court that the prayer of the Trustees' petition should be granted:

It is, on this 14th day of November, 1945, ORDERED that the Trustees of the Debtor be and they are hereby authorized and directed to pay to the State of New Jersey the

unpaid balances of the 1941 tax assessments as originally levied against the Trustees in respect of the railroad properties of the Debtor, said The Ogden Mine Railroad Company and said The Dover & Rockaway Railroad Company, together with interest thereon at the rate of 1% per month from December 1, 1941, without prejudice, however, to the petitioners' right under the provisions of Section 49 of Chapter 291 of the Laws of New Jersey of 1941 (L. 1941, p. 790) to have credited said principal and interest on account of any future taxes that may be due to the State of New Jersey, or their right to other redress, in the event the Court of Errors and Appeals reverses said decision and rule for judgment.

GUY L. FAKE
U. S. D. J.

Filed November 14, 1945.

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CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1946

No. 92

WALTER P. GARDNER, Trustee, of the Central Railroad Company of New Jersey,

Petitioner,

vs.

STATE OF NEW JERSEY,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF OF GROUP OF INSTITUTIONAL INVESTORS, WATTERS COMMITTEE OF BONDHOLDERS, BROOKS COMMITTEE OF BONDHOLDERS AND CENTRAL HANOVER BANK & TRUST COMPANY AS *AMICI CURIAE*

FRED N. OLIVER
WILLARD P. SCOTT
THOMAS RAEBURN WHITE
WILLIAM A. ROBERTS
PHILIP S. JESSUP
A. M. LEWIS

November 6, 1946.

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2 Collier on Bankruptcy, 14th Ed. Para. 2304, pp. 449-451 17

IN THE

Supreme Court of the United States

OCTOBER TERM, 1946

No. 92

WALTER P. GARDNER, Trustee of the Central Railroad Company of New Jersey,

Petitioner,

vs.

STATE OF NEW JERSEY,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR *AMICI CURIAE*

Statement

The undersigned members of the bar of this Court file the attached brief as *amici curiae*, pursuant to Rule 27 (9), on behalf of the Group of Institutional Investors, the Watters Committee of Bondholders, the Brooks Committee of Bondholders, and the Central Hanover Bank and Trust Company. There have been filed with the Clerk of this Court the written consents of all parties who have entered appearances here in this case.

This cause is here on certiorari to review the judgment of the Circuit Court of Appeals for the Third Circuit entered November 15, 1945 in the reorganization proceed-

ings under Section 77 of the Bankruptcy Act of the Central Railroad Company of New Jersey, reversing a judgment of the United States District Court for the District of New Jersey, entered March 5, 1945, holding that the District Court as a bankruptcy court had jurisdiction to adjudicate claims for taxes and penalties or interest filed by the State of New Jersey in the reorganization proceedings.

The parties joining in this brief consist of groups or committees of bondholders holding in the aggregate approximately one-quarter of the General Mortgage Bonds of the Central Railroad Company of New Jersey, and the Trustee of the General Mortgage, which constitutes a lien upon the properties and assets of the Debtor, and secures the only outstanding issue of the Debtor's bonds. They are the principal bondholder creditor parties to the reorganization proceedings, and were joined as appellees by the State in the Circuit Court. The writers of this brief concur in and adopt the statement of the case made by the petitioner, including his assignment of errors.

Summary of Argument

POINT I. THE BANKRUPTCY ACT GIVES THE BANKRUPTCY COURT JURISDICTION OVER THE PROOF AND ALLOWANCE OF CLAIMS, INCLUDING TAX CLAIMS.

1. Section 77 gives the court broad powers over proof and allowance of claims.
2. The language of Section 77 closely parallels that of the subsequent Section 57n, which Congress explicitly made applicable to tax claims.
3. The whole scheme of the Bankruptcy Act and the interpretation long given it by the courts make the Bankruptcy Court the proper forum for the evaluation and enforcement of liens.

4. It is even more important in reorganization cases than in ordinary bankruptcy that the Bankruptcy Court should be the forum for adjudication of lien disputes.

5. The question whether increment to taxes should be allowed as interest, disallowed as a penalty, or otherwise limited, is also a matter of Bankruptcy Law.

6. The contention that governmental lien creditors stand on a different footing from other governmental creditors is without support in the statute.

7. The Bankruptcy Court has jurisdiction not only of property to which the debtor had title, but all property of which the debtor had possession.

8. The Bankruptcy Court's power in this case is not dependent upon Section 64 of the Statute.

9. It being clear that the statute gives the Bankruptcy Court jurisdiction to evaluate liens, the only remaining contention is that the Bankruptcy Act is unconstitutional; and the Act's constitutionality has never before been challenged on such a ground because it has never occurred to anyone to view a state's efforts to enforce liens as suits against the State.

POINT II. THE CIRCUIT COURT ERRED BY MISTAKING THE JURISDICTIONAL QUESTION AT ISSUE IN THIS CASE FOR AN ATTACK ON THE ASSESSMENT METHODS OF NEW JERSEY, AND THUS DECIDED A QUESTION WHICH WAS NOT BEFORE IT.

1. The Circuit Court's opinion shows that it viewed the case as an attack on a tax assessment.

2. Loose reference to questions of law and pleas of *res judicata* as "jurisdictional" disguise the fact that the Bankruptcy Court very properly passed on nothing but the one jurisdictional question whether the State might claim sovereign immunity.

POINT III. THE CIRCUIT COURT ERRED IN HOLDING THAT THE DISTRICT COURT HAD NO JURISDICTION TO DETERMINE WHETHER A VALID TAX SETTLEMENT HAD BEEN MADE BY THE STATE AND THE TRUSTEES IN BANKRUPTCY.

1. By its holding the Circuit Court prevented a determination by the District Court of the question whether a valid tax settlement had been made by the State and the Trustee in Bankruptcy superseding the original assessment.

2. Whether such a settlement binding on the State has been made is a question of fact clearly within the jurisdictional competency of the District Court.

ARGUMENT

POINT I

The Bankruptcy Act gives the Bankruptcy Court jurisdiction over the proof and allowance of claims, including tax claims.

1. Section 77 Gives the Court Broad Powers Over Proof and Allowance of Claims.

Section 77 (c) (7) of the Bankruptcy Act provides:

> "The judge shall promptly determine and fix a reasonable time within which the claims of creditors may be filed or evidenced and after which no claim not so filed or evidenced may participate except on order for cause shown, the manner in which such claims may be filed or evidenced and allowed, and for the purposes of the plan and its acceptance, after notice and hearing, the division of creditors and stockholders into classes according to the nature of their respective claims and interests."

Section 77 (b) provides:

> "The term 'creditors' shall include, for all purposes of this section *all holders of claims of whatever character against the debtor or its property*, whether or not such claims would otherwise constitute provable claims under this Act, including the holder of a claim under a contract executory in whole or in part including an unexpired lease." (Emphasis added.)

The term "claims" is likewise broadly defined:

> "The term 'claims' includes debts, whether liquidated or unliquidated, securities (other than stock and option warrants to subscribe to stock), liens, or other interests of *whatever character.*" (Emphasis added.)

In addition to the specific grant of jurisdiction made by these paragraphs of Section 77, the jurisdiction to adjudicate tax claims and lien disputes concerning the estates in their possession which bankruptcy courts were exercising long before the enactment of Section 77 is given to the reorganization court by Section 77 (l), viz.:

> "In proceedings under this section and consistent with the provisions thereof, the jurisdiction and powers of the court, the duties of the debtor and the rights and liabilities of creditors, and of all persons with respect to the debtor and its property, shall be the same as if a voluntary petition for adjudication had been filed and a decree of adjudication had been entered on the day when the debtor's petition was filed."

Under the provisions of the statute, any claim which is not filed or evidenced within the time fixed by the judge is excluded from participation in the estate, an exercise of the

Congressional bankruptcy power which is certainly more drastic in its effect on tax liens than the mere grant to the court of the inherent power to determine the validity and extent of liens. That the exclusion of tardy claims from participation applies to tax liens is clear from the sweeping terms of 77 (b). "Claims" includes explicitly "liens or other interests of whatever character" and "creditors" includes "all holders of claims of whatever character". It would be hard to conceive of broader language. Not only are creditors defined as holders of claims "of whatever character", but they include "all holders", private or otherwise, and "claims" includes liens or "other interests of whatever character". A claim for taxes is at the very least an "interest". There are few more all-inclusive words in the legal vocabulary. Moreover, the provisions of Section 77 (c) 7 give the court power not only over the time of filing claims, but over the manner of filing and the manner in which they shall be allowed. They set up a scheme for the orderly and equitable handling of claims which is a *sine qua non* of any reorganization statute, and it is absurd to think that large classes of claims, or any class, could have been deliberately left out. There is nothing in the language that can remotely be construed as an exclusion; indeed, the definition of creditors as including holders of claims whether or not provable under the Act manifests an intention to grant even broader jurisdiction than given to bankruptcy courts under the earlier sections of the Act.

These provisions are not ambiguous. Their purpose is plain that the bankruptcy court shall fix the time within which all claims, whether secured or unsecured, shall be filed and the manner in which they shall be allowed. The District Court in this case entered an order in accordance with the statutory provisions and the State properly acted

thereon in filing its claim. These provisions, which expressly authorize the judge to determine the manner in which claims may be allowed, are all inclusive and, as a necessary prerequisite to consummation of a plan, must include tax claims as well as claims of any other character.

2. The language of Section 77 closely parallels that of the subsequent Section 57n, which Congress explicitly made applicable to tax claims.

The broad scope of the jurisdiction granted by Section 77 to adjudicate claims is indicated by reference to Congressional action with respect to other parallel provisions of the Bankruptcy Act. Prior to the 1938 amendments to the Bankruptcy Act, Section 57n contained no such broad and all-inclusive language as that incorporated in 1933 in Section 77 (c) 7. However, in 1938, the comprehensive revisions of the Act included a drastic amendment to Section 57n, doubtless in the light of the provisions of Section 77 (c) 7 adopted five years previously. The new language brought the former section into line with the previously broader provisions of the latter by providing:

> "n. Except as otherwise provided in this Act, all claims provable under this Act, including all claims of the United States and of any State or subdivision thereof, shall be proved and filed in the manner provided in this section. Claims which are not filed within six months after the first date set for the first meeting of creditors shall not be allowed: *Provided,* however, that the Court may, upon application before the expiration of such period and for cause shown, grant a reasonable fixed extension of time for the filing of claims by the United States or any State or subdivision thereof: * * *"

The Committee reports left no doubt as to the intent of Congress. The House report stated:*

> "(3) *Claims—Filing.*—Section 57: Subdivision n relating to the filing of claims has been entirely recast, and several significant changes have been made.
>
> "*All proofs of claim, except as otherwise provided in chapters X, XI, XII, and XIII, including claims for taxes and debts owing to a government, must be filed and proved.* The provision in respect to government claims is added in order to overcome the decisions which hold that the bar time for the filing of claims is not binding upon a sovereign. Thus the administration of the estate is speeded up, and the distribution becomes more certain and definite." (Emphasis added.)

The importance of this change was twice referred to in the Senate report:†

> "5. *Including Government claims within bar time—Extension of time*—(Section 57, Subdivision n, p. 76, lines 7 and 10-13). The House Bill includes within the bar time for the proving of claims, all claims of the United States and of any State or subdivision thereof. The committee has both strengthened and extended this proposed amendment by providing, first, that such claims must actually be filed within the bar time, and, second, by permitting additional time for the filing of such claims upon application for cause shown. *The committee agrees with the proposal that governmental claims should be subjected to the same requirements as other claims* but is of the opinion that the limitation should be tem-

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* House Report No. 1409 to accompany H. R. 8046, 75th Cong. 1st Sess. at p. 13.

† Senate Report No. 1916 to accompany H. R. 8046, 75th Cong. 3d Sess. at pp. 5, 16.

pered by the provision for extension, for the reason that it is sometimes difficult for the Government to prepare and present its claims within a fixed time. *The limitation will speed up the closing of estates,* and the extension will provide a reasonable flexibility.

* * * * * * * * *

"The provisions relative to the proof and allowance of claims have been greatly improved. Reference has already been made with reference to contingent claims and concerning the filing of Government claims and the extension of time therefor." (Emphasis added.)

It will be observed that the very purpose of this provision was to "subject governmental claims to the same requirements as other claims", a purpose already accomplished as to railroad reorganizations by the broad language of Section 77.

3. The whole scheme of the Bankruptcy Act and the interpretation long given it by the courts make the Bankruptcy Court the proper forum for the evaluation and enforcement of liens.

It is apparent, almost from the nature of the bankruptcy process, let alone from the statutory grant of power recited above, that the objections raised to the State's proof of claim must necessarily be heard and determined by a bankruptcy court. In this connection, attention is directed to the third and fourth objection to the State's proof of claim made by intervening creditors (R. 113-115). Objection 3(a) states that the State has no lien superior to the mortgagees' for amounts other than the principal of the taxes, and that the imposition of such a lien at that date would violate the rights of the mortgagees under the Fourteenth Amend-

ment. This is a question of relative priority of liens on a bankrupt estate, and citation of cases is almost superfluous to show that such a question is of the very essence of bankruptcy and reorganization law. Objection 3(b) is to the effect that the State has no lien on the personal property of the debtor for amounts greater than the principal of the taxes.

In *Isaacs* v. *Hobbs Tie & Timber Co.*,* this court said:

> "This is but an application of the well recognized rule that when a court of competent jurisdiction takes possession of property through its officers, this withdraws the property from the jurisdiction of all other courts which, though of concurrent jurisdiction, may not disturb that possession; and that the court originally acquiring jurisdiction is competent to hear and determine all questions respecting title, possession and control of the property. * * * *Thus, while valid liens existing at the time of the commencement of a bankruptcy proceeding are preserved, it is solely within the power of a court of bankruptcy to ascertain their validity and amount and to decree the method of their liquidation.*" (Emphasis added.)

In *Straton* v. *New*,† this Court said:

> "The purpose of the Bankruptcy Law, passed pursuant to the power of Congress to establish a uniform system of bankruptcy throughout the United States, is to place the property of the bankrupt, wherever found, under the control of the court, for equal distribution among the creditors. The filing of the petition is an assertion of jurisdiction with a view to the determination of the status of the bankrupt and a settlement and distribution of his estate. This jurisdiction is exclusive within the field defined

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* 282 U. S. 734, 737-738 (1931).
† 283 U. S. 318, 321 (1931).

> by the law, and is so far in rem that the estate is regarded as in custodia legis from the filing of the petition. . . . It follows that liens cannot thereafter be obtained nor proceedings be had in other courts to reach the property, the district court having acquired the exclusive right to administer all property in the bankrupt's possession. . . . *It may inquire into the validity of liens, marshall them, and control their enforcement and liquidation.*" (Emphasis added.)

These cases are only the latest expressions in the line of authority going back to *Whitney* v. *Wenman*,* in which the Court said:

> "We think the result of these cases is, in view of the broad powers conferred in Section 2 of the bankrupt act, authorizing the bankruptcy court to cause the estate of the bankrupt to be collected, reduced to money, and distributed, and to determine controversies in relation thereto, and bring in and substitute additional parties when necessary for the complete determination of a matter in controversy, that when the property has become subject to the jurisdiction of the bankruptcy court as that of the bankrupt, whether held by him or for him, jurisdiction exists to determine controversies in relation to the disposition of the same, and the extent and character of liens thereon or rights therein."

4. It is even more important in reorganization cases than in ordinary bankruptcy that the Bankruptcy Court should be the forum for adjudication of lien disputes.

Ascertaining the validity and relative priority of liens is even more conspicuously a primary duty of the bankruptcy court in a railroad reorganization case. In such a

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* 198 U. S. 539, 552 (1905).

case the corpus of the estate is almost entirely covered by liens. Disentangling the various liens, placing them in their proper rank, and estimating their value (so far as possible) are obviously indispensable first steps before the distribution of new securities under a plan of reorganization can be mapped with any pretense at fairness and equitability. In *Institutional Investors* v. *Chicago, Milwaukee, St. Paul & Pacific Railroad Company,* the Court said, "Here, as in the Consolidated Rock Products Company Case, the 'determination of what assets are subject to the payment of the respective claims' has a direct bearing on the fairness of the plan. . . . ." * It was there held that the District Court must resolve disputes as to liens.

5. The question whether increment to taxes should be allowed as interest, disallowed as a penalty, or otherwise limited, is also a matter of Bankruptcy Law.

The fourth objection made by intervening creditors to the State's proof of claim also concerns the accruals claimed by the State in addition to the principal amount, it being argued alternatively that they constitute a penalty not provable under the Act, or that for other reasons grounded in the peculiar circumstances of the case (which necessarily are not part of the present record and so are not before this Court and were not before the Circuit Court of Appeals) they should not accrue after the date of bankruptcy at the rate claimed by the State. The question whether an accrual is penalty or interest is one which has frequently come before bankruptcy courts for determination, sometimes with the result that the accrual was determined to be a

* 318 U. S. 523, 569 (1943).

penalty as in *New York* v. *Jersawit*,* sometimes with the opposite result, *Meilink* v. *California Unemployment Reserves Commission*.†

6. The contention that governmental lien creditors stand on a different footing from other governmental creditors is without support in the statute.

The proposition that a bankruptcy court has jurisdiction to determine the extent of liens is, as we have shown, almost axiomatic. The Circuit Court, as we shall attempt to demonstrate later, mistakenly grasped at one of the substantive objections to the State's proof of claim, assuming it to be the sole question in the case, and decided that rather than the jurisdictional question, which was the only one before it. The State's position, as we understand it, is that the assertions made in the State's proof of claim as to the existence and extent of its lien must be taken as final and cannot be inquired into, else the sovereign immunity of the State would be violated. There is no support in the statute for such a view.

The whole rationale of bankruptcy, of the marshalling and distribution of the assets of an insolvent estate, requires that a bankruptcy court be permitted to pass upon disputes over taxes secured by a lien even as upon disputes over unsecured taxes. If it were otherwise, not only states, but municipalities and other lesser taxing authorities, could, by the mere assertion of a lien, carve huge chunks out of the insolvent estate. There would be no need to determine whether a lien were perfected or inchoate, if it were once asserted; nor whether it had priority over other liens; nor would a

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* 263 U. S. 493 (1924).
† 314 U. S. 564 (1941).

bankruptcy court be allowed to determine the share of administrative expenses incurred in preserving property to which a lien had been asserted. The struggle over the corpus of an insolvent estate would be fought out not only in the bankruptcy court but in the tax bureaus, in the state tribunals and elsewhere.

If mere assertion of a lien were to free a taxing power from all the restraint imposed on other claimants, the tax claimant could intervene at any time and disrupt administration of an estate after it was well under way. This Court has already rebuked such a contention. In *New York* v. *Irving Trust Company*,* the bankruptcy court directed the filing of proof of all claims which the State of New York had against the bankrupt within 60 days after service of the order. No claim was filed by New York within the prescribed period but subsequently a notice of possible demand for additional taxes was presented. These taxes were secured by a lien.† The Trustee's motion to expunge the notice filed by New York was granted by the district court. Against the claim that this action was incompatible with state sovereignty, this Court upheld the action of the district court, saying:‡

> "The Federal government possesses supreme power in respect of bankruptcies. International Shoe Co. v. Pinkus, 278 U. S. 261, 265, 73 L. Ed. 318, 320, 49 S. Ct. 108. If a state desires to participate in the assets of a bankrupt, she must submit to appropriate requirements by the controlling power; otherwise, orderly and expeditious proceedings would be impossible and a fundamental purpose of the Bankruptcy Act would be frustrated."

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* 288 U. S. 329 (1933).
† *Carey* v. *Keith*, 250 N. Y. 216, 164 N. E. 912 (1928).
‡ 288 U. S. 329, 333 (1933).

The State of New Jersey, in its argument, does not, of course, contemplate such a chaos, where states and municipalities assert liens, and relying upon the finality of their own assertion, proceed eventually to their own execution unless paid off at the other creditors' expense. But such is the inevitable consequence of its interpretation of the statute. The explicit declaration of power to settle tax disputes, the State says, is in Section 64a; Section 64 deals primarily with a scheme of distribution for unsecured assets; therefore, a tax dispute arising as to secured assets must constitute a suit against the claimant. But this argument flies in the face of history and reason. It is far more consistent and sensible to say, as the courts have said for sixty years, that the power to settle disputes over tax claims is one of the powers of a bankruptcy court, whether by virtue of the express language of Section 64a or by virtue of the general grant of power to deal with claims and administer insolvent estates. It does not appear where in the Bankruptcy Act the court derives its jurisdiction to deal with secured tax claims at all, if not from one of these two sources; but the State reads into the statute an immunity only for state tax claims.

There are innumerable decisions where the courts have struggled with the question of proper treatment of tax claims, which could have been turned off quite simply if the assertion or even the establishment of a lien position for the taxes required the bankruptcy court to accept as final the claimant's assertions, upon peril of infringing his sovereign immunity.*

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* *e. g. Arkansas Corporation Commission* v. *Thompson*, 313 U. S. 132 (1941); *Board of Commissioners of Sweetwater County* v. *Bernardin*, 74 F. (2d) 809 (C. C. A. 10th, 1934); *In re Knox-Powell-Stockton Co.*, 100 F. (2d) 979 (C. C. A. 9th, 1939); *Eldredge Brewing Co.* v. *City of Portsmouth*, 118 F. (2d) 410 (C. C. A. 1st, 1941).

Moreover, under the State's interpretation of the Bankruptcy Act, a clash of lien claims between two sovereigns, such as two states or a state and the Federal Government (a not infrequent occurrence), could, if the Bankruptcy Court has no jurisdiction over lien claims, presumably be settled only by plenary proceedings in this Court.

A decisive refutation of the State's contention that the draftsmen of the Bankruptcy Act intended to leave State-claimed liens outside the jurisdiction of the bankruptcy court is found in Section 67 (c), expressly subordinating state tax liens, even when clearly ascertained and valid, on personal property, to wage claims and administration expenses. The inherent power of the Bankruptcy Court to rank and evaluate liens asserted but not otherwise established, surely, is a lesser power than the power to subordinate liens already established. Such a provision is utterly inconsistent with the State's theory that its claim upon the insolvent estate, because allegedly secured by a lien, is thereby withdrawn from the bankruptcy court's jurisdiction under the terms of the Act.

The claim of sovereign immunity under similar circumstances was unsuccessfully asserted in *New York* v. *Irving Trust Co., supra.* There is no question of acquiring jurisdiction over the person of the State to render a personal judgment. Jurisdiction of a *res* in *custodia legis* suffices to adjudicate interests claimed in the *res;* and both the statutes and the cases show that a bankruptcy court has jurisdiction over an insolvent estate sufficient to adjudicate liens therein and otherwise deal with them. The State comes into Court as a claimant, necessarily, and not as a defendant.

7. The Bankruptcy Court has jurisdiction not only of property to which the debtor had title, but all property of which the debtor had possession.

The fundamental fallacy of the State's position in this proceeding arises from its misconception, derived from inapposite language in Sections 64 and 70 of the Bankruptcy Act, that the estate in *custodia legis* consists only of the unencumbered assets to which the Debtor had title. On the contrary, the estate in *custodia legis* consists of all assets of which the debtor had *possession*, whether encumbered or not. So it has been consistently held through fifty years of bankruptcy history.*

That this is so is shown by one of the very quotations that the State cited to the Circuit Court. On Page 23 of its brief, citing *Missouri* v. *Fiske*,† it quoted:

> "The fact that a suit in a Federal Court is in rem or quasi in rem furnishes no ground for the issue of process against a nonconsenting state. If the State chooses to come into the Court as plaintiff or to intervene, *seeking the enforcement of liens* or claims, the State may be permitted to do so, and in that event its rights will receive the same consideration as those of other parties in interest. But when the State does not come in and withholds its consent, the Court has no authority to issue process against the State to compel it to subject itself to the Court's judgment, whatever the nature of the suit." (Our emphasis.)

In this case, there is no question of issuing process against the State. The estate is in *custodia legis*, and if

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* *White* v. *Schloerb*, 178 U. S. 542, 44 L. Ed. 1183 (1900); 2 Collier on Bankruptcy, 14th Ed., Para. 2304, pp. 449-451, and cases there cited.

† 290 U. S. 18, 28 (1933).

the State wishes to enforce its liens it may come in (as it has done in fact). If it does not come in, it runs the risk that its lien may not be enforced, which is squarely and precisely what happened in *Van Huffel* v. *Harkelrode*.*

That bankruptcy administration has always comprehended state liens was clearly indicated in the opinion of Mr. Justice BRANDEIS in *Van Huffel* v. *Harkelrode*. In that case the Supreme Court confirmed the jurisdiction of the bankruptcy court to sell property of the bankrupt free of state tax liens, although it was admitted that the bankruptcy court had erroneously denied priority to the lien. Justice BRANDEIS said: †

> "No good reason is suggested why liens for state taxes should be deemed to have been excluded from the scope of this general power to sell free from encumbrances. Section 64 of the Bankruptcy Act grants to the court express authority to determine 'the amount or legality' of any tax. To transfer the lien from the property to the proceeds of its sale is the exercise of a lesser power; and legislation conferring it is obviously constitutional. Realization upon the lien created by the state law must yield to the requirements of bankruptcy administration."

8. The Bankruptcy Court's power in this case is not dependent upon Section 64 of the Statute.

It will be noted that Justice BRANDEIS apparently thought that Section 64, giving the Bankruptcy Court power to "hear and determine" all disputes as to the "amount and legality" of any tax, was a declaration of power to adjudicate liens. In this respect Section 64 was only declaratory

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* 284 U. S. 225 (1931).
† 284 U. S. at page 228.

of a power granted elsewhere in the Bankruptcy Act. When the draftsmen first came to deal with taxes, in Section 64 of the Act as it stood prior to the 1938 amendments, they added the proviso that the Bankruptcy Court should "hear and determine" disputes regarding taxes, to prevent any confusion arising from the preceding direction that the court should order the payment of taxes. However, Section 64 dealt primarily with a scheme for the distribution of free assets; and for this reason, particularly after it was re-drawn and compressed in 1938, there was doubt as to the extent of Section 64's applicability to secured claims and to reorganizations, so much so that this Court expressly reserved the point as to Section 77, in *Arkansas Corporation Commission* v. *Thompson*. The whole of the State's case as to statutory interpretation is bottomed on the coincidental presence of this clause in Section 64. But it is plain that the power to adjudicate disputes over taxes and liens claimed therefor is inherent in a bankruptcy court, and has always been treated as such. In *Lyford* v. *City of New York*,* the Circuit Court of Appeals for the Second Circuit, in a thorough opinion holding Section 64a not inconsistent with Section 77, and therefore applicable under Section 77 (l), in so far as it dealt with power to adjudicate tax claims, said:

> "Moreover, we do not see that our problem would be greatly changed, however our conclusion is expressed as to this point. If there was no provision expressly dealing with the power to adjudicate tax claims, the court would still have to find that such a claim was legally due; its general power to pass upon claims would require no less." (Id. at p. 785)

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* 137 F. (2d) 782 (1943).

9. It being clear that the statute gives the Bankruptcy Court jurisdiction to evaluate liens, the only remaining contention is that the Bankruptcy Act is unconstitutional; and the Act's constitutionality has never before been challenged on such a ground because it has never occurred to anyone to view a state's efforts to enforce liens as suits against the State.

The only argument of the State which has not been long since settled against it is that the Bankruptcy Act is unconstitutional because it empowers the bankruptcy court to deal with contentions put forward by a state that its tax claims are secured. As far as we are aware, it is the first time the constitutionality of the Bankruptcy Act has been challenged on such a ground.

Heretofore there has been no suggestion that conflict could arise between the bankruptcy power, one of administering insolvent estates, and the Eleventh Amendment, forbidding the prosecution of law suits against a state. But it is not necessary to argue that the Bankruptcy Power overrides the Eleventh Amendment. The real answer is that throughout our history, claimants, whether private or municipal or state, have had to come to the bankruptcy court to present their claim for adjudication; they have not been allowed to proceed to self-help unless permitted by the bankruptcy court. Such an interpretation of the law fulfills the purpose of a bankruptcy court, the centralized, simultaneous and expeditious disposition of claims, and could not possibly be viewed as a suit against the claimant; and therefore no conflict has arisen or can arise between the Bankruptcy Power and the Eleventh Amendment. The de-

cision of this court in *Ashton* v. *Cameron County*,* contains no suggestion to the contrary, since it was grounded not upon the Eleventh Amendment but upon general concepts of state sovereignty.

POINT II

The Circuit Court erred by mistaking the jurisdictional question at issue in this case for an attack on the assessment methods of New Jersey, and thus decided a question which was not before it.

1. The Circuit Court's opinion shows that it viewed the case solely as an attack on a tax assessment.

We believe that the Court of Appeals fell into error because of its too great familiarity with the long history of litigation over New Jersey railroad tax assessments. The question before the Circuit Court was purely a preliminary one of jurisdiction, whether the Bankruptcy Court could pass upon objections to the State's proof of claim. The District Court had found that it could, over the protests of the State based upon its novel theory of sovereign immunity. The Circuit Court sustained neither the State nor the District Court, for it allowed the Bankruptcy Court jurisdiction while reversing its order; but instead it passed to one of the substantive objections to the State's proof of claim and held that the objection was precluded by *Arkansas Corporation Commission* v. *Thompson, supra.*

The opinion of the Court of Appeals occupies ten pages in the Federal Reporter; and it is not unfair to say that,

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*298 U. S. 513 (1935).

apart from some attention given to the history of the case, five of those pages are devoted to description of New Jersey assessment procedure and the other five to comparison of the New Jersey procedure with the Arkansas procedure which in *Arkansas Corporation Commission* v. *Thompson* was held to be a final disposition of an assessment question. In other words, the Circuit Court erroneously assumed that the issue before it was an attack by the Trustee on the New Jersey method of assessing real property, a question which had not been briefed or argued. In fact, none of the substantive objections to the State's claim had ever been presented even to the District Court, because of the State's jurisdictional objection. The most expeditious procedure —and, incidentally, the one which the Trustee and intervening creditors desired—would have been to bring the jurisdictional objection of the State and the numerous substantive objections to the State's claim up for simultaneous disposition. But it so happened that the preliminary jurisdictional question rose all the way to the Circuit Court, which then looked over the jurisdictional question to the substantive question which it erroneously believed to be at the bottom of the case, and so disposed of the matter.

Not even the State thought, in its briefs before the Circuit Court, that the case was concluded by *Arkansas Corporation Commission* v. *Thompson*. The State did not rely on the *Arkansas* case until its brief in opposition to the petition for certiorari in this Court, and even then it seemingly picked up with reluctance the weapon forged by the Circuit Court. The Circuit Court's conclusion that the Bankruptcy Court may pass upon only "mathematical error in the computation of the amount of the tax, or legal error in assessment" is indeed at variance with the position of the State, and does not answer the sole question before the Circuit Court.

2. Loose reference to questions of law and pleas of *res judicata* as "jurisdictional" disguise the fact that the Bankruptcy Court very properly passed on nothing but the one jurisdictional question whether the State might claim sovereign immunity.

Sharp attention should be directed to a certain confusion in the use of the term "jurisdiction", which has permeated the State's position and contentions in this case and which has seemingly misled the Circuit Court. The State tends to elevate questions of law into questions of jurisdiction: *e. g.*, it argues that the bankruptcy court has no "jurisdiction" to review the assessment because of the *Arkansas* case; that it has no "jurisdiction" to uphold the objections to the State's claims because the state court litigation (to which the trustees were not parties) decided the question and is "binding"; that the bankruptcy court has no "jurisdiction" to look into the penalty interest because of the *Meilink* decision, and so forth.

These arguments are arguments of law which should be made to the bankruptcy court when it passes on the objections to the State's proof of claim. They do not go to the question whether the court may hear the objections. It may well be that the bankruptcy court will agree with the State in all these contentions. No one knows, because the bankruptcy court has never had the opportunity to pass on them.

The question of the binding effect of state law is not relevant to the question now before this Court. A bankruptcy court must first determine, in the nature of things, whether a question before it is one of state law or one of bankruptcy law; and second, if there is a question of state law, what the state law is; and third, to what extent rights under state law as thus established are to be preserved and

enforced in bankruptcy. The effect of the State's position in this case is to require the bankruptcy court to accept as final a state claimant's assertions on all three of these questions.

No such solution of State law questions can be applied to this problem because whether a question is one of state or Federal law, and how State law rights once established are to fare in a bankruptcy administration, cannot be so settled.

The Circuit Court, as we have demonstrated, did not in fact sustain the plea of sovereign immunity raised by the State; but it jumped over the jurisdictional objection and decided what it thought was the substantive question, although (a) none of the substantive questions have ever been briefed and argued and the record has not been completed nor come before any court; and (b) such a decision concludes not only these questions, but quite possibly questions not as yet raised or even conceived.

POINT III

The Circuit Court erred in holding that the District Court had no jurisdiction to determine whether a valid tax settlement had been made by the State and the Trustees in Bankruptcy.

1. By its holding the Circuit Court prevented a determination by the District Court of the question whether a valid tax settlement had been made by the State and the Trustee in Bankruptcy superseding the original assessment.

One of the most important substantive questions, not yet decided, is the effect of the acceptance by the Trustees of the offer made by the Tax Settlement Acts and action taken

thereunder. The Circuit Court of Appeals appears to have assumed that the decision of the New Jersey Court of Errors and Appeals,* holding these Acts unconstitutional in a case stated between the attorney general and the state treasurer, foreclosed any further consideration of the application of the Acts to the Debtor's tax liabilities.

Such assumption ignores the nature of the proceedings in that case, the extent to which it would bind the Bankruptcy Court, and the rules as to acquisition of rights which may be acquired under a statute which is later held unconstitutional.

Wilentz v. *Hendrickson* † was instituted by information filed by the attorney general of New Jersey, praying an injunction against the State Treasurer against enforcement of the Tax Settlement Acts. The case was tried upon the pleadings, upon affidavits, and upon stipulated facts (133 N. J. Eq. 451). Neither the Debtor nor any other railroad was a party to the proceedings. In spite of this opportunity so to frame the issues as to answer all possible defenses of the Acts, the Court of Errors and Appeals, in discussing the central issue of the case—whether the readjustment of liabilities was supported by consideration—referred three times to the insufficiency of the proofs, and emphasized *the lack of proof* that the taxes were "uncollectible" (135 N. J. Eq. 252, 256, 260).

In view of the lack of identity of parties, and of the court's own emphasis of the lack of proof on a controlling issue in the case, it is manifest that this decision is neither *res judicata*, nor a conclusive decision of the State Court which would be binding on the Bankruptcy Court: *Rutter* v. *Patterson*, 73 N. J. L. 467. If the Bankruptcy Court

* *Wilentz* v. *Hendrickson*, 135 N. J. Eq. 244.
† 133 N. J. Eq. 447.

should determine, on competent evidence, that the State tax claims were uncollectible in whole or in part when the Tax Settlement Acts became applicable, its decision as to their validity could, without running contrary to New Jersey law, differ from the decision in the *Wilentz* case.

There also remains completely undetermined the question of rights and equities the Debtor may have acquired by its action taken in reliance on the Tax Settlement Acts. These Acts were passed by the State legislature and approved by the Governor in the attempt to solve the apparently hopeless quandary of the railroads which were in reorganization, and to gain an advantage for the State in the shape of immediate tax payments. The solution offered by the Acts was accepted by the railroads, with the approval of the Bankruptcy Court, but after objection by the Attorney General of the State was made to its *jurisdiction*, the Circuit Court held in effect that the Bankruptcy Court had no power to decide whether the Debtor had so changed its position as to have acquired rights or equities. It is clear that rights protected by the contract clause cannot be defeated by the decision of the highest court of a State construing its own constitution (*Combes* v. *Getz*, 285 U. S. 434). It is equally well settled that vested rights acquired under a statute will not be destroyed by a subsequent declaration in a proceeding between different parties that the statute is unconstitutional: *Chicot County Drainage District* v. *Baxter State Bank*, 308 U. S. 371. In *J. A. Dougherty's Sons* v. *Commissioner*, 121 F. (2d) 700 (C. C. A. 3d) it was said (p. 703):

> "Nowhere is the propriety of recognizing and accrediting a status produced by a statute before its unconstitutionality has been judicially declared more strongly indicated than it is in the case of tax statutes. The subject taxpayer is under compulsion to pay due regard to the requirements of the statute

until its invalidity has been authoritatively adjudicated."

2. Whether such a settlement binding on the State has been made is a question of fact clearly within the jurisdictional competency of the District Court.

Neither the Bankruptcy Court nor any other court has been given the opportunity to receive evidence as to the effect of the action which the Debtor was required to take and did take in accepting the provisions of the Tax Settlement Acts. The nature of the rights and equities which it acquired by virtue of this action and their relation to the Debtor's estate as a whole must, it is submitted, be determined by the Bankruptcy Court.

It should be noted that no question as to the construction of either constitution or statute has arisen. The only question which will be presented to the District Court is whether *under the facts as they may appear* there was a donation. The contention that the amount of the original assessments of the State authorities is the final amount due is of no validity, for the State itself by passing the Settlement Acts reopened the question and made a new determination as to the amount of taxes due.

Conclusion

For the reasons stated above, the decision of the Circuit Court of Appeals should be reversed.

Respectfully submitted,

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November 6, 1946.

APPENDIX

Pertinent Sections of the Bankruptcy Act

Section 2

"The courts of the United States hereinbefore defined as courts of bankruptcy are hereby created courts of bankruptcy and are hereby invested, within their respective territorial limits as now established or as they may be hereafter changed, with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this Act, in vacation, in chambers, and during their respective terms, as they are now or may be hereafter held, to— . . ."

(7) "Cause the estates of bankrupts to be collected, reduced to money and distributed, and determine controversies in relation thereto, except as herein otherwise provided, and determine and liquidate all inchoate or vested interests of the bankrupt's spouse in the property of any estate, whenever under the applicable laws of the State, creditors are empowered to compel such spouse to accept a money satisfaction for such interest."

Section 23 (a)

"The United States district courts shall have jurisdiction of all controversies at law and in equity, as distinguished from proceedings under this Act, between receivers and trustees as such and adverse claimants, concerning the property acquired or claimed by the receivers or trustees, in the same manner and to the same extent as though such proceedings had not been instituted and such controversies had been between the bankrupts and such adverse claimants."

Section 57 (n)—As Amended

"Except as otherwise provided in this Act, all claims provable under this Act, including all claims of the United States and of any State or subdivision thereof, shall be proved and filed in the manner provided in this section. Claims which are not filed within six months after the first

date set for the first meeting of creditors shall not be allowed: *Provided, however,* That the court may, upon application before the expiration of such period and for cause shown, grant a reasonable fixed extension of time for the filing of claims by the United States or any State or subdivision thereof: *Provided, further,* That, except in proceedings under Chapters X, XI, XII, and XIII of this Act, the right of infants and insane persons without guardians, without notice of the bankruptcy proceedings, may continue six months longer: *And provided further,* That a claim arising in favor of a person by reason of the recovery by the trustee from such person of money or property, or the avoidance by the trustee of a lien held by such person, may be filed within thirty days from the date of such recovery or avoidance, but if the recovery is by way of a proceeding in which a final judgment has been entered against such person, the claim shall not be allowed if the money is not paid or the property is not delivered to the trustee within thirty days from the date of the rendering of such final judgment, or within such further time as the court may allow. When in any case all claims which have been duly allowed have been paid in full, claims not filed within the time hereinabove prescribed may nevertheless be filed within such time as the court may fix or for cause shown extend and, if duly proved, shall be allowed against any surplus remaining in such case."

Section 57 (n)—Prior to Amendment

"Claims shall not be proved against a bankrupt estate subsequent to six months after the adjudication; or if they are liquidated by litigation and the final judgment therein is rendered within thirty days before or after the expiration of such time, then within sixty days after the rendition of such judgment: *Provided,* That the right of infants and insane persons without guardians, without notice of the proceedings, may continue six months longer."

Appendix

Section 64 (a) (4)—As Amended

"The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be . . . (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof; *Provided*, That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court: *And provided further*, That, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court; and"

Section 64 (a)—Prior to Amendment

"The court shall order the trustee to pay all taxes legally due and owing by the bankrupt to the United States, State, county, district, or municipality, in the order of priority as set forth in paragraph (b) hereof: Provided, That no order shall be made for the payment of a tax assessed against real estate of a bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court. Upon filing the receipts of the proper public officers for such payments the trustee shall be credited with the amounts thereof, and in case any question arises as to the amount or legality of any such tax the same shall be heard and determined by the court."

Section 77 (c) (7)

"The judge shall promptly determine and fix a reasonable time within which the claims of creditors may be filed or evidenced and after which no claim not so filed or evidenced may participate except on order for cause shown, the manner in which such claims may be filed or evidenced and allowed, and for the purposes of the plan and its acceptance, after notice and hearing, the division of creditors

and stockholders into classes according to the nature of their respective claims and interests. Such division shall not provide for separate classification unless there be substantial differences in priorities, claims, or interests. The trustee or trustees under any mortgage, deed of trust, or indenture outstanding against the property may, within the time prescribed, file a verified claim in behalf of all bonds or securities outstanding under such mortgage, deed of trust, or indenture, in which event it shall be unnecessary for the holders of such bonds or securities to file claims in their own behalf, but nothing herein shall constitute such trustee or trustees the representative or representatives of such holders for the purpose of accepting or rejecting any plan of reorganization."

Section 77 (l)

"In proceedings under this section and consistent with the provisions thereof, the jurisdiction and powers of the court, the duties of the debtor and the rights and liabilities of creditors, and of all persons with respect to the debtor and its property, shall be the same as if a voluntary petition for adjudication had been filed and a decree of adjudication had been entered on the day when the debtor's petition was filed."

IN THE

Supreme Court of the United States

OCTOBER TERM, 1946.

No. 92.

WALTER P. GARDNER, Trustee of The Central Railroad Company of New Jersey,

A Debtor-Petitioner,

vs.

THE STATE OF NEW JERSEY,

A Creditor.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

BRIEF ON BEHALF OF THE CITY OF JERSEY CITY, NEW JERSEY, *AMICUS CURIAE.*

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1946, No. 92.

WALTER P. GARDNER, Trustee of The Central Railroad Company of New Jersey,

A Debtor-Petitioner,

vs.

THE STATE OF NEW JERSEY,

A Creditor.

BRIEF ON BEHALF OF THE CITY OF JERSEY CITY, NEW JERSEY, *AMICUS CURIAE.*

(Italics supplied, except as otherwise stated.)

Interest of *Amicus Curiae.*

The City of Jersey City files this brief *amicus curiae* pursuant to Rule 27, par. 9, as a political subdivision of the State of New Jersey. The interest of the city in the subject matter of this controversy arises from the fact that it is statutory distributee of approximately thirty per cent of the taxes assessed by the State of New Jersey against The Central Railroad Company of New Jersey, R. S. 1937, 54:24-11, and of accrued interest thereon. *Jersey City* v. *Zink*, 133 N. J. L. 437, 44 Atl. (2d) 825. It is thus apparent that any defeat or impairment of the State's tax and inter-

est claim against the railroad seriously affects the pecuniary interests of the City of Jersey City. The City of Jersey City respectfully submits that the judgment of the Third Circuit Court of Appeals reversing the order of the district court was correct in result and should be affirmed, but proposes to confine this brief to argument in support of the following narrow propositions:

1. The bankruptcy court was without jurisdiction to entertain the attempt of the trustee and his late co-trustee to enforce compliance by the State of New Jersey with the contract allegedly made by the state and the trustees of the debtor in the form of the Railroad Tax Settlement Acts (P. L. 1941, Ch. 290, and P. L. 1942, Ch. 241), since the subject matter of that alleged contract was extrinsic to and did not arise out of the same transaction as the State's tax and interest claims, so that the enforcement of the contract against the State would constitute a suit against the State by a citizen thereof without its consent.

2. Should this Court determine that the bankruptcy court possesses jurisdiction to determine the existence of the said alleged contract and to enforce compliance therewith by the State, the bankruptcy court should, nevertheless, be directed, in the exercise of appropriate discretion under the circumstances presented, to refer to the New Jersey courts for adjudication the issues arising with respect to the constitutionality and effectiveness, as to the trustee, of the Railroad Tax Settlement Acts.

Statement of the Case.

(1)

The Tax Claims of the State.

On October 30, 1939, the United States District Court for the District of New Jersey approved the debtor's petition filed under Section 77 of the Bankruptcy Law (R. 1). On January 8, 1940, Shelton Pitney and Walter P. Gardner qualified as trustees. The latter survives as sole trustee.

Thereafter, the Comptroller of the State of New Jersey filed "proofs of claim" for balances of property taxes assessed for the years 1932 to 1939, inclusive, together with statutory interest (R. 34). The amount computed by the state in the reply of the state to "Supplemental and Amended Objections and Defenses of Debtor's Trustees," etc. to be due from the debtor for said tax years, as of September 1, 1941, is $14,140,887.53 for taxes, and $12,626,173.50 for interest (R. 94), together with minor sums due from debtor's subsidiaries (R. 103, 104, 106, 107). The tax delinquencies arose as a result of the withholding by the debtor of from 40% to 50% of the annual levies concurrently with litigation against the amount and legality of the taxes assessed conducted by the debtor and other major railroad companies in New Jersey, in both the state and federal courts, all of which litigation was determined adversely to the railroads and culminated with the denial of certiorari by the United States Supreme Court in the 1934, 1935 and 1936 cases on April 28, 1941 (318 U. S. 568). See the full description of the litigation in the Reply of the State to the "Supplemental and Amended Objections and Defenses

of Debtor's Trustees to Claims filed by the State of New Jersey" (R. 97-102).

Objections were filed by the trustees to the proofs of claim originally filed by the State Comptroller, reciting various objections to the taxes under the New Jersey statutes and Constitution (R. 72, 73, 74), and, in addition, specific objections to the assessments on grounds of violation of the equal protection and the due process clauses of the 14th Amendment to the Federal Constitution (R. 73, 74), and of the Interstate Commerce and Bankruptcy clauses thereof (Article I, Sec. 8) (R. 74, 75). Reply to the objections was filed by the Attorney General.

The issues raised on the "proofs of claim" were referred to a Special Master on April 1, 1941 (R. 48, par. 11), but the order of reference was revoked by Order No. 163 prior to the holding of any hearings.

(2)

The Railroad Tax Settlement Acts and the New Jersey litigation as to constitutionality thereof.

On July 22, 1941, the legislature of New Jersey adopted Chapter 290 of the Laws of 1941, which purported to waive and remit the liability for interest which had accrued on delinquent railroad taxes for the years 1932 to 1940, inclusive, owing by debtor and the other major railroad systems operating in New Jersey (other than the Pennsylvania Railroad Company, which, though joining in the legal attacks upon the assessments, always paid the taxes in full on time), and to postpone the time for payment of principal taxes over periods of years varying from 2 to 20 years.

In the case of the debtor the period was 20 years. The statute required that the railroads file with the State Treasurer waivers of any right further to contest the assessments for the years 1932 to 1940, inclusive, and also for the then current year of 1941.

Chapter 290 further provided that the statutory agreements to pay the principal sums and the waivers and discontinuances of appeals should be approved by the Attorney General before acceptance by the State Treasurer. Being of the opinion that the statute violated a prohibition against donations to private corporations contained in Article I, par. 20 of the Constitution of New Jersey, the Attorney General declined to consider the sufficiency of the documents and, on September 4, 1941, filed a civil information in the Court of Chancery of New Jersey seeking to enjoin the State Treasurer from acting under the statute (R. 50, par. 16).

On August 8, 1941, the bankruptcy court ordered the trustees to make the required tender's under Chapter 290. The consequent tenders by the trustees were declined by the State Treasurer because the Attorney General had not approved them.

On December 23, 1941, the legislature of New Jersey adopted Chapter 391 of the Laws of 1941, authorizing and directing the State Treasurer to defend the information proceedings brought by the Attorney General and appropriating funds for the hiring of counsel to defend the constitutionality of the act. Pursuant thereto the State Treasurer engaged as counsel Josiah Stryker, senior member of the firm of Lindabury, Depue & Faulks (now Stryker, Tams & Horner), of Newark, New Jersey, Herbert J. Hannoch, of

that city, J. H. Thayer Martin, Newark lawyer who had been State Tax Commissioner of New Jersey from 1931 to 1941, and had made all of the railroad tax assessments in question, and T. Millet Hand, of Cape May, now a member of Congress from New Jersey. These distinguished members of the New Jersey Bar conducted the defense of the constitutionality of said Chapter 290 and of the later and interrelated Chapter 241 of the Laws of 1942, before the Court of Chancery and the Court of Errors and Appeals of New Jersey.

Though the Central of New Jersey trustees and the other railroad companies were immediately apprised of the institution of the Chancery litigation by the refusal of the State Treasurer to accept the tenders of documents and checks made by them under the act, they never applied to be admitted as parties, being obviously content with the defense of their interests in the Chancery suit by the capable counsel acting in that behalf as counsel for the State Treasurer. The Attorney General, of course, could not have made the trustees parties to the information proceedings in view of the restraint entered below against the institution of any suit against the debtor or the trustees at the inception of the bankruptcy.

After issue was joined in the information proceedings, the legislature, on May 21, 1942, adopted Chapter 241 of the Laws of 1942, which purported to amend Chapter 290 in certain respects later found by the New Jersey courts to have been devised for the purpose of buttressing the tax settlement plan against the constitutional objections made by the Attorney General. *Wilentz* v. *Hendrickson*, 135 N. J. Eq. 244, 248, 38 Atl. (2d) 199 (E. & A., 1944), affirming

133 N. J. E. 447 (Ch. 1944); 33 Atl. 2d. 366. The two statutes are hereinafter referred to as the Settlement Acts.

Among other things, Chapter 241 eliminated the requirement that the Attorney General approve the settlement documents. It was further provided that any railroad which desired to comply, should enter into the required agreement to pay the full amount of taxes assessed for the years 1932 to 1940, and make the first installment payment on or before June 15, 1942.

Section 7 of Chapter 241 provided that upon a default by any railroad taxpayer in the making of any installment payment due under the statutory plan, the full amount of taxes and statutory interest penalties previously due from the taxpayer should again become due and payable. The 20-year period for the making of installment payments applicable to the debtor under Chapter 290 was unchanged by Chapter 241. In the case of the debtor, therefore, the statute contemplated an arrangement which might be executory for twenty years.

On the day of the adoption of Chapter 241, the Attorney General, being of the opinion that the basic constitutional infirmities persisted, filed a Supplemental Information, and on the same day the Court of Chancery on his application temporarily restrained the State Treasurer from carrying out or executing any of the provisions of the act. See *Wilentz* v. *Hendrickson, supra* (135 N. J. Eq. at p. 248). The restraining order was continued from time to time and was made permanent by final decree of the Court of Chancery on September 28, 1943 (R. 77). Pursuant to the restraint the State Treasurer has at all times refused to accept any documents or payments from any railroad com-

pany, including the trustees, and such tenders were "consequently * * * without legal effect." See *In re Central R. Co. of N. J.*, 136 F. (2d) 633, 638 (C. C. A. 3rd, 1943); cert. den. 320 U. S. 805.

Subsequent to the adoption of Chapter 241 of the Laws of 1942, and while the civil information was pending undetermined in the Court of Chancery, the trustees herein petitioned the bankruptcy court for an order adjudicating the tax claims of the State of New Jersey in the amounts and on the terms fixed by the Settlement Acts, representing to the court that they were entitled to such adjudication forthwith by way of compensation for certain disadvantages and burdens allegedly imposed upon them by said acts. Over objection by the Attorney General the court made its Order No. 163* agreeably to the request of the trustees, adjudicating the tax claim of the state for the years 1932-1940 at the amount of the principal taxes as computed by the trustees and disallowing the interest charges.

On appeal by the State of New Jersey to the Third Circuit Court of Appeals, Order No. 163 was reversed. *In re Central R. Co. of N. J., supra,* the Court stating that the district court had by its orders necessarily adjudicated the constitutionality of the Settlement Acts without affording the state a hearing on the question, and that (136 Fed. (2d) at p. 638)

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* Order No. 163 and the petition therefor are not printed in the record herein. It was stipulated by the parties below, however, "that any party may refer to or quote *in extenso* any of the orders, minutes, exhibits or other portions of the record in the bankruptcy court, in his brief or at the oral argument of No. 8861 and No. 8889, or either of them, or in the course of any review of the judgment or judgments entered therein." (R. 147).

> "It would, therefore, have been appropriate, in the exercise of a wise discretion, for the district court to have stayed its hand until the state court had determined whether the tax settlement acts were valid or a nullity."

Subsequently, on July 20, 1943, after full proofs were made by both sides and the question as to the constitutionality of the acts was argued in full, the Court of Chancery disposed of an application by the State Treasurer to dismiss the restraints theretofore entered on the ground that the acts were constitutional, by denying such application and filing an exhaustive opinion concluding that the acts were in violation of Article 1, par. 20, of the New Jersey Constitution. *Wilentz* v. *Hendrickson*, 133 N. J. Eq. 447, 33 Atl. (2d) 366 (Ch. 1943). In its opinion the Court noted that:

> "The constitutional questions involved have been elaborately debated by counsel with much industry, learning and ability. Voluminous affidavits have been submitted and examined. The numerous decisions cited in the briefs have been studiously explored." (133 N. J. Eq. at p. 454.)

Thereafter, on September 28, 1943, after final hearing, the court made its final decree adjudging the statutes null and void as in contravention of Article I, par. 20, of the New Jersey Constitution, and permanently restraining and enjoining the State Treasurer from carrying out or executing the provisions of the acts and from accepting any payments or papers pursuant thereto (R. 77).

Upon appeal by the State Treasurer to the Court of Errors and Appeals, the decree was affirmed, the court

filing an opinion agreeing with the conclusion of the Court of Chancery that the Settlement Acts were in violation of Article 1, par. 20, and affirming the decree below for the reasons stated *both* in the opinion of the Court of Errors and Appeals *and in the opinion of the Court of Chancery. Wilentz* v. *Hendrickson, supra* (135 N. J. Eq. 244, 261).

It may be noted that the opinions of both the Court of Errors and Appeals and the Court of Chancery concluding that the Settlement Acts violated Article I, par. 20, of the State Constitution, were based almost entirely upon the determination of questions of *law* and *not*, as petitioner maintains, solely of fact. Without discussing the matter here at length, a reading of the reported opinions which, as seen above, represent, in combination, the considered view of the Court of Errors and Appeals, will demonstrate that the gravamen of unconstitutionality was found to consist of the *donative intent* of the New Jersey legislature in passing the acts in question. That intent was found to be manifest from the preamble of Chapter 290, the detailed statement in Chapter 241 of the purposes and objects of the act, the "considerations" upon the basis of which the legislature stated in Section 15 of the act, as amended, that it was making the remissions of interest in question, and the general background preceding and attending the adoption of the acts, which was a matter of common public knowledge in New Jersey. (See 133 N. J. Eq. at pp. 476, 480, 484, 487, and 135 N. J. Eq. at pp. 247, 248, 249, 253).

The analyses by both New Jersey courts of the "considerations" which were asserted by the State Treasurer to support and validate the remissions of interest were undertaken primarily from the standpoint of determining

whether they were of such a nature as to indicate that the legislature acted out of a donative intent, as forbidden by the Constitution, or out of a purpose to contract with the railroad companies, as contended by the State Treasurer. See 133 N. J. Eq. at pp. 476, 483. The court held, moreover, that the unquestionably *illegal* consideration for the remissions, consisting of the plain legislative intent to use public moneys in fostering and promoting public transportation by privately operated railroad companies, vitiated, as a matter of law, any otherwise valid considerations as might arguably exist, such as the undertaking of the railroads to discontinue pending tax litigation, 133 N. J. Eq. at p. 484.

Even the analysis of the question as to whether the surrender of the tax litigation constituted a "consideration" must be regarded as essentially a determination of law, rather than of fact, since any judgment with respect to whether the pending tax appeals were substantial rather than merely of nuisance value had to depend upon a consideration of the legal effect of previous judicial determinations of tax litigation. Again, the question presented was clearly one of law, rather than of fact. See 133 N. J. Eq. at p. 483; 135 N. J. Eq. at pp. 258, 259, 260.

(3)

Circumstances leading to entry of Order No. 271.

Instead of abiding by the decision of the New Jersey courts in *Wilentz* v. *Hendrickson, supra*, as the Third Circuit Court of Appeals clearly implied should have been done in its opinion reversing Orders No. 163 and No. 171,

In re Central R. Co. of N. J., supra (136 F. (2d) at pp. 638, 640; *cert. den.* 320 U. S. 805), the trustees filed their petition in the District Court below on August 12, 1944 (R. 43), reciting the history of the tax claim to that date, including the adoption of the Settlement Acts and the tenders by the trustees in asserted compliance therewith; that such compliance had resulted in the consummation of a valid and binding contract (R. 60, par. 29); that the decision of *Wilentz* v. *Hendrickson* turned upon questions of fact only, not binding upon the trustees since they were not made parties to said proceedings (R. 54, par. 23); that there existed many considerations flowing to the state, so far as the debtor and trustees were concerned, which rendered the Settlement Acts constitutional as to them, if not as to other railroad companies (R. 56, par. 26); that if the decision in *Wilentz* v. *Hendrickson* deprived the trustees of the benefit of their contract, it constituted an illegal (presumably unconstitutional) impairment of their contract which was valid when made (R. 60, par. 29); that if the court determined that neither the trustees nor the state were bound by the said contract, the bankruptcy court would be required to pass upon the trustees' objections to the proofs of claim and upon the relative rights and priorities of the state and other lienholders (R. 62, par. 30); and that in view of all of the foregoing the trustees prayed that the court adjudicate (R. 62, 63):

> "(1) whether petitioners entered into a contract with the State of New Jersey, (2) whether such contract is binding on the parties thereto, (3) whether, if not binding on the State, petitioners are nonetheless bound by the prejudicial actions taken by them, (4)

if not binding on the parties thereto including petitioners, to what extent, if at all, the proofs of claim of the State of New Jersey should be allowed, (5) what order should in such event be made to restore the equivalent of the *status quo ante* as nearly as may be and (6) what in such event are the relative rights, claims, liens and priorities of the claimants in the assets of the Debtor's Estate; and that this Honorable Court may instruct petitioners whether to make on or before December 1, 1944 the additional payment on account of the taxes claimed and the additional interest payment required by Chapter 290 of the Laws of 1941, as amended by Chapter 241 of the Laws of 1942."

The petition was subsequently supplemented by the "Supplemental and Amended Objections and Defenses of Debtor's Trustees to Claims Filed by the State of New Jersey" (R. 83), which, in substance, restated the position taken in the August 12, 1944, petition, specifically set forth the Settlement Acts as defenses to the state's interest claims (R. 83, par. 1), and further claimed "alternatively" (R. 84, par. 5), that if the contention of the state that the Settlement Acts were without force or effect as applied to the trustees and to the debtor's estate should be sustained, then the tax claims should be reduced on the basis of the original objections of the trustees to the proofs of claim, same being incorporated in the "Supplemental Objections, etc." by reference, and for other reasons specifically recited and founded upon the 14th Amendment to the United States Constitution (R. 84, 85, 86). It was further therein contended, alternatively, that the claims of the state for interest should be reduced or disallowed on various grounds (R. 86, par. 9).

The state filed a special appearance objecting to the entertainment of the trustees' petition of August 12, on various jurisdictional grounds, including the attempt therein to obtain specific performance against the state of an alleged contract without the state's consent (R. 78).

On October 16, 1944, by its Order No. 250, the court referred the tax claims of the state, including the questions raised by the trustees with respect to the alleged contract arising out of the Settlement Acts, and also the jurisdictional questions raised by the state, to a Special Master for hearing and report (R. 80). The Special Master filed an interim report concluding that the bankruptcy court had possessed jurisdiction to determine the tax claims of the state and "that the claim of the state to sovereign immunity should be denied" (R. 116). Upon objections of the State of New Jersey to the interim report (R. 129), the district court entered Order No. 271 overruling the objections of the state and confirming the interim report of the Master (R. 138).

The judgment of the Third Circuit Court of Appeals under review in the present case reversed Order No. 271. (R. 168).

(4)

The pending appeal to the Third Circuit Court of Appeals from Order No. 260.

Notwithstanding the fact that the state had appealed from Order No. 250 below, because of the refusal of the bankruptcy court to determine the jurisdictional question raised by the state, the trustees and the Special Master

were preparing to go forward with the taking of testimony on all issues, meritorious, as well as jurisdictional. The state was therefore confronted with the prospect that the bankruptcy court was proposing to embark on a judicial inquiry which the Attorney General conceived should be referred to the state courts, if the bankruptcy court had jurisdiction at all. Accordingly, on December 11, 1944, the Attorney General filed and served a notice of motion and petition, requesting leave of the court to join the trustees as parties defendant in a suit to be instituted in the courts of New Jersey for a declaratory judgment "as to whether the debtor and its trustees entered into a contract with the State of New Jersey pursuant to the provisions of the Settlement Acts and whether such contract is binding on the parties thereto", and further praying for a modification of Order No. 250 so that pending the final determination of the state court proceedings the special master be directed not to proceed with the hearing of any matters of law or fact involving the constitutionality or applicability of the Settlement Acts to the debtor and the trustees. After hearing, the court entered Order No. 260, denying the application for the sole stated reason that:

> "* * * to grant the relief prayed for in said petition would result in further and prejudicial delay in the hearing and adjudication of the State's claim and in the reorganization of the Debtor and would not be in the public interest or in accordance with the intent of Congress in enacting Section 77 of the Bankruptcy Act." *

* Reference is made to the contents of Order No. 260 pursuant to the stipulation below, hereinabove referred to, under which any of the parties reserved the right to refer to and quote from any part of the bankruptcy record below (R. 147).

The state has appealed to the United States Third Circuit Court of Appeals from Order No. 260 and the cause has been listed on the docket of that court as No. 8808. A brief has been filed by the state therein, but an understanding was arrived at between the Attorney General and the trustees that the said appeal would not be proceeded with until the final determination of the jurisdictional question involved on the appeal from Order No. 271.

If this Court concludes that the bankruptcy court had jurisdiction, but that we are, nevertheless, sound in contending that, in the alternative, all issues with respect to the constitutionality and applicability of the Settlement Acts to the trustee should be referred to the New Jersey courts for determination, the pending said appeal of the state to the Third Circuit Court of Appeals from Order No. 260 will be superseded.

The City of Jersey City, as *amicus curiae*, presses the point that the said issues should be remanded to the New Jersey courts because both the dictates of sound public policy and the pecuniary interests of the city require that the entirety of this tax controversy be finally disposed of at as early a date as possible. It is now over two years since the New Jersey Court of Errors and Appeals adjudged the Settlement Acts unconstitutional. Both the state and its participating municipalities, including the City of Jersey City, have now been waiting for periods of time up to fourteen years, for a liquidation by the debtor of its tax and interest obligations. If this Court concludes that the bankruptcy court possesses jurisdiction in the premises, but that the sound exercise of discretion calls for the submission of the issues with respect to the constitu-

tionality and applicability to the trustee of the Settlement Acts to the courts of New Jersey for final determination, a great service could be rendered to all parties in interest if the Court were to make such a direction at this point, rather than simply reverse the judgment below and permit the additional delay of many months which would be required to argue the questions raised on the appeal from Order No. 260 before the Third Circuit Court of Appeals, and to further litigate the same questions before this Court on appeal or certiorari of any determination by the Circuit Court of Appeals.

ARGUMENT.

I.

The trustees' petition for an adjudication by the Bankruptcy Court as to the existence and binding effect of the "Settlement Acts" contract constitutes a suit against the State without its consent, which the Court is without jurisdiction to entertain.

The briefs of the parties to this appeal have discussed at length the question as to whether the attempt by the trustees to secure an adjudication by the bankruptcy court effective against the state, that there is in existence a binding and effective contract between the trustees and the State of New Jersey, under which the debtor is liable to the state for only so much money as is called for by the Settlement Acts, constitutes a suit against the state without its consent. As above stated, we agree with the position of the Attorney General that it is, and that the bank-

ruptcy court is therefore without power to make the adjudication. The purpose of the argument made under this Point of the present brief, however, is to demonstrate that, assuming the soundness of the contention of the trustee to the effect that the proofs of claim filed by the state in the bankruptcy court are tantamount to the institution of an action by the state against the debtor, thus opening the door to the introduction of proper defenses against such claims, the assertion by the trustee of non-liability on the basis of the supposed binding effect of the Settlement Acts contract is not within the rule stated, and the entertainment by the bankruptcy court of that question constitutes an allowance of a suit against the state without its consent.

(1)

The Settlement Acts "contract" is an entirely different transaction than the assessment of taxes and accrual of interest, and cannot found a permissible cross-claim against the State's claim.

It is very well settled that in order for a cross claim to be maintainable against an action by a state, and to be free from interdiction as a suit against the state without its consent, the subject matter of the cross claim must arise out of the same transaction as the claim of the state. *In re Monongahela Rye Liquors, Inc.*, 141 F. (2d) 864 (C. C. A. 3rd, 1944); *Re Patterson-MacDonald Ship Building Co.*, 293 F. 192 (C. C. A. 9th, 1923); *Aplin* v. *Grand Traverse County*, 73 Mich. 182, 41 N. W. 223; *Bates* v. *Republic*, 2 Tex. 616; *State* v. *B. & O. R. Co.*, 34 Md. 344, aff'd 21 Wall. 456; *Raymond* v. *State*, 54 Miss. 562; *Battle* v. *Thompson*, 54 N. C. 406; *Moore* v. *Tate*, 87 Tenn. 725, 11 S. W. 935;

White v. *Governor*, 18 Ala. 767; *People* v. *Conner*, 59 Hun. 299, aff'd 128 N. Y. 640, 29 N. E. 147; *State* v. *Holgate*, 107 Minn. 71, 119 N. W. 792, 793; and see *Bull* v. *United States*, 295 U. S. 247, 262; *United States* v. *Eckford*, 6 Wall. (U. S.) 484; *Reeside* v. *Walker*, 11 How. (U. S.) 272, 290.

An explicit application of the rule stated is found in *In re Monongahela Rye Liquors, Inc.* In that case, which was a petition for reorganization of a corporation under Chapter X of the Bankruptcy Act, the State of Pennsylvania had filed proofs of claim with the referee in specified amounts for unpaid capital stock, corporate loan and income taxes. The trustee filed objections to the tax claims and sought set-off or recoupment on account of claims for liquor sold by the bankrupt to the State Liquor Control Board and argued that the amount of the taxes due could not be determined until the trustee's counterclaims were passed upon, since the tax claims were based on estimates of the Pennsylvania Department of Revenue, upon failure of the corporation to file proper returns. The Commonwealth of Pennsylvania moved to dismiss the objections on the ground that the bankruptcy court had no jurisdiction to pass upon tax claims and that, in any event, there was no right in the trustee to maintain the cross claim against the Commonwealth. The appellate court held that the cross claims were not allowable. In so holding, the court stated (141 F. (2d) 864, at p. 869)

> "While Sec. 68, Sub. a of the Bankruptcy Act, 11 U. S. C. A. Sec. 108, Sub. a, provides that 'In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid,'

it has been held that this section is to be interpreted in the light of the established doctrines of set-off at common law and in equity. Cf. *Cumberland Glass Mfg. Co.* v. *DeWitt and Company*, 237 U. S. 447, 454, 455; *In re Rosenbaum Grain Corporation*, 7 Cir. 103 F. 2d, 656, 658 * * *.

"A distinguishing feature of set-off is that it arises out of a transaction extrinsic to that out of which the primary claim arose. Cf. *Hastorf* v. *Degnan-McLean Contracting Co.*, D. C. N. Y., 128 F. 982, 983. In short a set-off rests upon a claim or demand based upon an independent cause of action. The independent nature of set-off is plainly recognized by the Federal Rules of Civil Procedure. * * * The present importance of the distinction between a counterclaim and a set-off lies in the fact that, under both federal and local law, in a suit by a sovereign a plea of set-off, being based as it is upon matter unrelated to the primary claim, is the equivalent of an independent suit against the sovereign which, of course, may not be sued without its consent. See *Nassau Smelting & Refining Works, Ltd.* v. *United States*, 266 U. S. 101, 106; *Commonwealth* v. *Matlack*, 4 Dall. Pa. 303, 1 L. Ed. 843.

* * *

"It is, of course, true that when the United States or a State institutes a suit, it thereby submits itself to the jurisdiction of the court, but, as to claims against the sovereign, the latter's submission to a court's jurisdiction, because of its suit, draws in only such adverse claims as have arisen out of the same transaction which gave rise to the Sovereign's suit. Cf. *Bull* v. *United States*, 295 U. S. 247, 261, 262; *United States* v. *Dugan Bros. Inc.*, 36 F. Supp. 109, 110; *State* v. *Holgate*, 107 Minn. 71, 119 N. W. 792, 793. A defendant's right in such regard is one of recoupment, and in *Bull* v. *United States*, *supra*, it is

> said that 'recoupment is in the nature of a defense arising out of some feature of the transaction upon which the plaintiff's action is grounded.' The rule of recoupment in bankruptcy derives from the rule that the trustee takes the bankrupt's property subject to the equities therein. It does not attach by reason of the set-off provision of Sec. 68, Sub. a, 4 Remington on Bankruptcy, 5th Ed. Sec. 1435."

From the careful statement of the applicable rule by the Third Circuit Court of Appeals in the foregoing case, and from the other decisions cited above, it clearly appears that in the instant case the bankruptcy c ırt can claim jurisdiction over the state by virtue of the filing of the state's tax claim, if at all, only in respect of such matters as arise out of the same transaction as that upon which the state's tax and interest claims are based. Careful examination of the nature of the trustee's cross claim against the state in the instant case, as framed in its petition to the court of August 12, 1944 (R. 43), clearly discloses that the cross claim is one for specific performance of an alleged executory contract between the trustee and the state arising out of a transaction distinctly *extrinsic* to that upon which the state's tax claims are based.

We will demonstrate under the next subpoint that the executory nature of the contract and the non-existence to date of any completed accord prevents the existence of any state of affairs which could be considered a *defense* to the state's tax claims. We will there further show that where the cross claim against the state is of that character, there is presented an independently sufficient basis for the declination by the court of jurisdiction against the state on such a claim. We confine our attention under the pres-

ent subpoint to a showing of the complete independence of the two transactions which underlie, respectively, the claim of the state and the cross claim of the trustees.

The "transaction" which founds the claim of the state is constituted by the assessment of taxes for each of the years in question which are in arrears, and the nonpayment of such taxes when due, giving birth to the continuous accrual of the statutory interest charges. The basic proofs of claim of the state were filed in 1940 (R. 64). The "transaction" which gives rise to the cross claim for specific performance against the state, on the other hand, is founded upon two acts of the New Jersey legislature, adopted in 1941 and 1942, respectively, argued by the trustee to constitute a binding contractual offer by the state, and upon the asserted acceptance thereof by the trustees, resulting, it is claimed, in a binding and enforcible contract. Under the contract, if the trustees would agree to waive and discontinue certain litigation then pending respecting the legality and amount of taxes theretofore assessed against the railroad, and would agree to make payment of the principal taxes assessed in installments over a period of twenty years, together with 3% interest on unpaid balances from December 1, 1940, the state's claim for interest on accrued taxes would be abated and cancelled. P. L. 1941, Ch. 290; P. L. 1942, Ch. 241.

Under the alleged contract, moreover, should any of the annual installments of taxes due under the agreement not be paid when due, then the remaining unpaid balance of taxes, together with all of the original interest charges, were immediately to become due and payable. P. L. 1942, Ch. 241, Sec. Since, moreover, The Central Railroad

Company of New Jersey was given twenty years within which to pay its principal taxes (R. 50, par. 14), under the formula set up in Section 2 of P. L. 1941, Ch. 290, the situation contemplated by the Settlement Act was one wherein a final and conclusive determination as to the amount of money owing from the railroad to the state could not be made until the expiration of twenty years after the passage of the act.

We submit that the foregoing recital demonstrates that the so-called Settlement Act contract is an entirely separate and distinct transaction from the original tax assessment transaction, in the sense in which the difference in the transactions is material under the rule stated in the above cited cases. The rationale of the rule seems to be that the filing of a claim or suit by a state constitutes a consent to the adjudication by the court of any matter of recoupment presentable by the defendant against the state. Certainly, there was no intention, actual or constructive, on the part of the State Comptroller who filed the proofs of claim on behalf of the state with the trustees in 1939, to consent, on behalf of the state, to the entertainment of jurisdiction by any court thereafter in an action for specific performance of a contract which might later be made between the state and the trustee, and which, in this case, was not made until the years 1941 and 1942.

Assuming there is jurisdiction in the bankruptcy reorganization court to entertain questions with respect to the amount or legality of taxes claimed by the state against the debtor and the trustee, the trustee's attempt to submit to the court for determination the question as to the constitutionality, under the New Jersey Constitution of the Set-

tlement Acts, and as to the binding effect of the alleged contract said to have arisen upon the basis of the enactment of those acts, does not raise a question pertaining to the amount or legality of taxes.

The original transaction upon which the state's claim is based is a tax assessment transaction. The later transaction upon which the trustee bases his cross claim is a contract transaction (or, more properly speaking, a gift upon condition) which not only includes as part of its subject matter the then accrued taxes and interest, but also includes divers other subject matters, such as discontinuances of pending tax litigations, waivers of objection to assessment of 1941 taxes, an agreement to pay 3% interest charge on accumulated deficiencies since December 1, 1940, etc., all of which was to remain partially executory for twenty years.

In principle, the situation before the court is not dissimilar from that which would exist if the state had made an agreement with the trustees to cancel part of the railroad's tax debt in consideration of an agreement by the railroad to carry all merchandise shipped by any state department or agency, or its municipalities, free of charge for a period of twenty years, and if the state later refused to execute the agreement as unconstitutional. Could it be contended that upon the filing by the state of a proof of claim for the taxes the bankruptcy court was vested with jurisdiction specifically to enforce such an agreement against the state without the consent of the state, merely because part of the consideration with which the contract dealt involved taxes?

We submit the transactions are distinct and separate, and the state cannot be compelled, without its consent, to submit to a suit to specifically enforce the Settlement Acts contract by mere reason of its filing the original proofs of claim.

(2)

The petition of the trustee seeks original relief of an affirmative nature and therefore cannot be interposed as a cross claim against the claim of the state.

It seems clearly established not only, as shown in the next preceding subpoint, that the cross claim must arise out of the same transaction as the state's claim in order for the maintenance of the latter to found jurisdiction for the entertainment by the court of the former without the state's consent, but also that if the cross claim seeks original and independent relief, the court is without jurisdiction to entertain it against the state without its consent. *Port Royal & A. Railway Co.* v. *South Carolina*, 60 F. 552, 553 (C. C. S. C., 1894); *Howard* v. *Cook*, 83 P. (2d) 209 (Id., Sup. Ct.). In the *Port Royal & A. Railway Co.* case cited above, the court said (60 F. at p. 553):

> "If this cross bill, on examination, be found to relate to any other matter than that contained in the original bill; if it seeks to inject new and foreign matter in the suit; if we find it abandons the proper office of defense, and seeks original and independent relief,—it is an improper cross bill, and is demurrable."

From the review of the Settlement Acts hereinabove, and of the posture of the proceedings at the time the trus-

tees filed their petition of August 12, 1944, setting forth their cross claim, there can be little question that the trustees do seek original and independent relief of an affirmative nature against the state.

It will be recalled that when that petition was filed there was in existence a decree of the New Jersey Court of Chancery (R. 77), subsequently affirmed by the New Jersey Court of Errors and Appeals, the state's highest tribunal, restraining and enjoining the state treasurer from "carrying out or executing any and all of the provisions of Chapter 290 of the Laws of 1941, and of Chapter 241 of the Laws of 1942, and from accepting from any railroad taxpayer any acceptance documents, discharges, or dismissals, discontinuances, checks or other forms of payment which may be delivered to him, * * *, or which were heretofore delivered to him, * * *, in purported compliance with Chapter 290 of the Laws of 1941 and Chapter 241 of the Laws of 1942, and from depositing any such checks or other forms of payment, or distributing the proceeds thereof."

This injunction continues in full force and effect to date. The state treasurer is the only official authorized by the Settlement Acts to execute and consummate the Settlement Act contract on behalf of the state. He has steadfastly declined to do so in obedience to the mandate of the courts of the State of New Jersey. The request of the trustees that the bankruptcy court adjudicate, with binding effect against the state, whether they entered into a contract with the state and whether such contract is binding on the state (R. 62, 63), is plainly a request that the court enter a decree which would, in effect, specifically enforce the contract with

the state. No official of the State of New Jersey is at liberty to effectuate an acquittance of the railroad of its tax or interest obligation, notwithstanding what the bankruptcy court, or any other court other than the New Jersey Court of Chancery or the New Jersey Court of Errors and Appeals, might determine. Only those tribunals can lift or modify the presently pending restraint against the enforcement or consummation of the Settlement Act. So far as the government of New Jersey is concerned, it continues to be the duty of the proper officials of the state to effectuate collection of the full amount of taxes and interest owing by the railroad to the state, anything contained in the Settlement Acts to the contrary notwithstanding.

Although we are not here debating the question as to the power of the federal bankruptcy court to compel the State of New Jersey and its agents to abide by any decree which it might make with respect to the amounts of money owing by the railroad to the state for taxes and interest, we emphasize that the enforcement of such a decree, conflicting with the existing decree of the New Jersey Courts invalidating the Settlement Acts contract, would constitute the exertion of affirmative action and power against the state, through action upon its responsible officials, and that a suit having that object may not be maintained against the state without its consent under the rule hereinabove set forth.

That the cross claim necessarily encompasses affirmative relief is more clearly seen when the executory nature of the Settlement Acts contract is taken into account. The so-called contract was not self-executing, under the terms of the statute. Assuming that the tender by the trustees of

the settlement documents called for by the Settlement Acts was in the nature of an acceptance of a contractual offer by the state, and that such offer was in compliance with the statute (which is not conceded), there did not result, under the Settlement Acts, an accord and satisfaction of the existing tax claims of the state against the railroad. This is for the reason that the accord was not executed. It was not executed for two reasons: First, the acceptance of the tenders by the only state official authorized by statute so to do, the state treasurer, was enjoined by the New Jersey Court of Chancery and that injunction later was affirmed by the New Jersey Court of Errors and Appeals. Second, the transaction was of a nature such that it was not contemplated to be fully executed until some undetermined future date, possibly twenty years subsequent to the entry into the compromise agreement. This is for the reason, hereinabove noted, that part of the consideration flowing from the railroad was its undertaking to pay the principal taxes assessed, together with 3% interest thereon from December 1, 1940, in installments over a period of time which, in the case of the Central, might be twenty years. Under the act, P. L. 1942, Ch. 241, Sec. 7, the entire original obligation for taxes and interest was to be revived upon any default in the payment of an installment of principal for a period of thirty days.

To constitute a bar, an accord must be executed, not merely executory. *Stone* v. *Todd*, 49 N. J. L. 274, 281 (Sup. Ct., 1887); 8 Atl. 300. In 1 Am. Jur. 252, Sec. 65, the rule is stated as follows

> "In order that a demand or cause of action may be barred by an accord, the general rule is that the accord must be executed. *Why the payment is not*

actually made or the accord executed is apparently immaterial. The promise is to satisfy, and until the promise is fulfilled the agreement is not binding, and since it is not a bar to an action on the original debt, it follows that is of no consequence as a bar to the original claim, whether the failure to perform may be attributed to the fault of either or neither party."

An unconditional acceptance by the creditor is necessary to establish an accord and satisfaction. 1 *Am. Jur.* 224, Sec. 23. The trustee may seek to urge, in opposition to the contention we here make, that the railroad has recently made a payment to the state which is large enough to discharge its entire remaining obligation for principal taxes and that therefore the Settlement Acts contract is no longer executory. Any such contention would fail, however, for at least two reasons.

It is true that on May 6, 1946, the railroad made payment to the state of $15,250,000 (R. 318), under and pursuant to Order No. 333 of the District Court (R. 296). But under the terms of the said order, which was consented to by the state, the state has studiously avoided any implication that the state officials were agreeing to accept the said sum under and pursuant to the Settlement Acts. The order is free from any reference to the Settlement Acts. Any interpretation of the order as calling for an acceptance of the said payment by the state officials under those acts is impossible, since the injunction made by the New Jersey courts against the acceptance of any moneys or documents under and pursuant to the Settlement Acts continues in full force and effect, and no New Jersey state official will knowingly violate it.

In the second place, the New Jersey Supreme Court has, on application of the Attorney General in another case, recently decided that where a railroad taxpayer owes principal and interest, the state officials may not accept and appropriate exclusively to principal a payment on account made by the railroad. *State* v. *Erie Railroad Company*, 23 N. J. Misc. 203 (Sup. Ct., 1945); 42 Atl. (2d) 759. The official position of the state, therefore, is that the said $15,250,000 paid by the railroad to the state in May, 1946, must be applied ratably to principal and interest, pursuant to the said rule of *State* v. *Erie Railroad Company*, and accordingly a substantial amount of principal taxes, as well as interest, remains due and owing to the state of New Jersey. The Settlement Acts contract (putting to one side the fundamental question as to its constitutionality and applicability to the trustees) continues to be executory.

For all of the reasons stated, the enforcement of the cross claim of the trustees against the state necessarily involves the entertainment by the court of bankruptcy of a suit involving independent relief of an affirmative nature against the state without its consent, and, therefore, offends the rule that a court of the United States has no jurisdiction to entertain a suit against a state without its consent.

(3)

No court possesses jurisdiction to entertain a claim of set-off against a tax obligation.

The third basis for rejecting jurisdiction of the court to entertain the cross claim of the trustees, growing out of the nature of the claim and cross claim, is that the cross

claim is set off against a tax claim, a device which has universally been held impermissible. *City of Camden* v. *Allen*, 26 N. J. L. 398 (Sup. Ct., 1857); *Enterprise* v. *Rowls*, 204 Ala. 528, 529, 86 So. 374; *Finnegan* v. *Fernandina*, 15 Fla. 379; *Tarner* v. *Dolton*, 134 Ga. 462, 67 S. E. 929; *Somerset* v. *Somerset Banking Co.*, 109 Ky. 549, 556, 60 S. W. 5; *Charlotte* v. *Kean*, 207 N. Y. 346, 100 N. E. 1116; *Gatling* v. *Cateret County*, 92 N. C. 536; *Milo* v. *Milo Water Co.*, 131 Me. 372, 163 Atl. 163; *Apperson* v. *City of Memphis* (C. C. W. D. Tenn., 1879), 2 Flipp. 363, Case No. 497, 1 Fed. Cas. 1068.

It is not an adequate response to our contention that the subject matter of the cross claim is, in part, related to the tax obligation. That very situation was presented in both *Milo* v. *Milo Water Co.* and *Apperson* v. *City of Memphis*, both *supra*.

In the *Milo* case, an action in debt by a town for an unpaid tax assessment owing by a water company, the latter sought to off-set the alleged liability of the town for water under a contract by which the town had agreed to pay the water company for water supplied the town, in part, "such further sum each year as shall equal the amount of tax, if any, assessed against said company by said Town of Milo during said year." The cross claim was rejected, the court holding (131 Me. 372, at p. 380):

> "Lastly, it would seem that recoupment, counterclaim or set-off is not available to defendant. Recoupment as such relates to damages arising out of breach of the same contract or transaction as that sued on (citing cases). There is clearly no basis for recoupment as such in a suit for taxes.

> "And the rule, based on the ground of public policy, seems sound that no set-off or counterclaim is admissible against demands for taxes levied for local governmental purpose. * * *"

Similarly, in the *Apperson* case, *supra*, the court held that it was powerless to permit as an off-set against a liability for a general city tax, a claim against the city on scrip issued to indemnify taxpayers who had previously voluntarily paid an illegal tax.

To recapitulate, the bankruptcy court had no jurisdiction to entertain the cross claim based upon the Settlement Acts contract against the State of New Jersey without its consent, because:

1. The Settlement Acts transaction was a different transaction than the tax assessment transaction.

2. The cross claim seeks the independent and affirmative remedy of specific performance of an executory contract against the state.

3. The cross claim is in the nature of a set-off or recoupment against taxes.

II.

If the Bankruptcy Court has jurisdiction to entertain the cross claim of the Trustee, the matter of the constitutionality of the Settlement Acts and their applicability to the Trustee should be referred to the New Jersey courts for determination in the interests of "the appropriate relationship between Federal and State authorities functioning as a harmonious whole."

We have heretofore pointed out that there is pending before the United States Third Circuit Court of Appeals, but not yet argued, an appeal by the Attorney General from the denial by the bankruptcy court of an application to grant the Attorney General leave to join the trustees as parties defendants in a declaratory judgment proceeding in the courts of New Jersey for the purpose of securing a final and specific adjudication of the question now raised by the trustees as to constitutionality and applicability, *as to The Central Railroad Company of New Jersey*, of the Settlement Acts.

In our introductory remarks hereinabove we requested that, should this Court determine that the bankruptcy court possesses jurisdiction to determine the existence of the Settlement Acts contract, and to enforce compliance therewith by the state, notwithstanding the legal argument to the contrary in the brief of the Attorney General and hereinabove in this brief, the Court should, nevertheless, direct that the bankruptcy court, in the exercise of appropriate discretion, refer the issue thus arising under the laws and constitution of New Jersey to the courts of New Jersey.

For purposes of the present Point, we concede that the trustee's attempt to establish that, as to him and the debtor, a constitutional and valid contract has arisen out of the Settlement Acts, notwithstanding the decision in *Wilentz* v. *Hendrickson, supra,* represents a justiciable controversy. The pertinent issue, however, is whether, under all of the circumstances here obtaining, that inquiry should be embarked upon by the bankruptcy court, or whether, in the appropriate exercise of discretion, the court should not call to its aid and assistance the New Jersey courts which must, in the final analysis, have the ultimate say with respect to the meaning and effect of the laws and Constitution of the State of New Jersey.

We submit that the recent decisions of the United States Supreme Court in comparable situations have left no room for debate but that the latter is the appropriate and practically mandatory course to pursue. *Spector Motor Service* v. *McLaughlin,* 323 U. S. 101; *Chicago* v. *Fieldcrest Dairies,* 316 U. S. 168; *Railroad Commission of Texas* v. *Pullman Co.,* 312 U. S. 496; *Thompson* v. *Magnolia Petroleum Co.,* 309 U. S. 478; and see *Meredith* v. *Winter Haven,* 320 U. S. 228; *Burford* v. *Sun Oil Co.,* 319 U. S. 315; *Watson* v. *Buck,* 313 U. S. 387, 401; *Great Lakes Dredge & Dock Co.* v. *Huffman,* 319 U. S. 293, 298; *Matthews* v. *Rodgers,* 284 U. S. 525, 526; *Arkansas Corporation Commission* v. *Thompson,* 313 U. S. 132, 145; and see *Alabama State Federation of Labor* v. *McAdory,* 325 U. S. 450.

In *Spector Motor Service* v. *McLaughlin, supra,* more fully discussed in Point III of this brief, the United States Supreme Court cited (323 U. S. 105) with approval the decision in *In re Central R. Co. of N. J.,* 136 F. (2d) 633

(C. C. A. 3rd, 1943), as one authority, among others, for the proposition that "federal courts do not decide questions of constitutionality on the basis of preliminary guesses regarding local law." It will be recalled that in the *Central Railroad* case *supra*, cited by the United States Supreme Court, the Third Circuit Court of Appeals found that it was improper for the bankruptcy court below to have made a determination of the tax claims of the State of New Jersey on the basis of the Settlement Acts at a time when the question as to the constitutionality of such acts was actually pending, undetermined, in the New Jersey Court of Chancery (136 F. (2d) at p. 638).

How much more impelling is the situation now obtaining, when the then awaited Chancery decision has since been rendered and affirmed by the New Jersey Court of Errors and Appeals, both holding flatly that the Settlement Acts violate Article I, Paragraph 20, of the State Constitution. If the ruling of the Third Circuit Court of Appeals in the prior *Central Railroad* case was sound, and even the trustee will hesitate to dispute that, in view of the express approval thereof by the United States Supreme Court in the *Spector* case, *supra*, then, *a fortiori*, the justiciable question now raised by the trustee as to whether the Settlement Acts are specifically valid as to the debtor on the basis of such showing of facts as he wishes to make, should be referred to the state courts, as the Attorney General proposes.

The quoted portion of the heading of this point is taken from the recent decision of the Supreme Court in *Chicago v. Fieldcrest Dairies, supra.* We submit that the situation there was almost a perfect parallel with that here obtaining.

In that case an action was brought in a federal district court for a declaratory judgment as to the construction and validity of a municipal ordinance of Chicago which required that milk sold in quantities of less than one gallon "should be delivered in standard milk bottles." The city declined to permit the respondent to sell milk in paper containers, whereupon the latter brought the action referred to, alleging that its containers were within the ordinance, and, if not, that the ordinance violated the state and federal constitutions. Issue was joined and the matter referred to a master in May, 1939. In July, 1939, the state law was passed regulating the use of paper milk containers and permitting municipal regulations of distribution of milk, if not in contravention of the law. On April 27, 1940, the master reported that the respondent's containers were not in compliance with the ordinance and that the ordinance was valid. The district court, on exceptions, held the containers were "standard milk bottles" and that under the state law the city could not prohibit their use. On appeal the Circuit Court of Appeals held the containers were not "standard milk bottles," but that the ordinance violated the state law and would be unconstitutional if it did prohibit the use of such containers.

On May 15, 1940, while the case was pending before the district court, the Dean Milk Company, of which respondent was a subsidiary, instituted a state court action against the city raising the same question involved in the federal proceedings. After judgment was entered by the federal district court, and pending the appeal, the Dean Milk Company moved in the state court for a decree in its favor and such decree was entered in December, 1940, the court re-

taining jurisdiction pending final determination of the appeal in the federal court.

On certiorari, the United States Supreme Court said (316 U. S. at p. 171):

> "We granted the petition for certiorari * * * because *of the doubtful propriety of the District Court and of the Circuit Court of Appeals in undertaking to decide such an important question of Illinois law instead of remitting the parties to the state courts* for litigation of the state questions involved in the case. *Railroad Commission* v. *Pullman Co.*, 312 U. S. 496."

The court then went on to make the following significant disposition of the matter (316 U. S. at pp. 172, 173):

> "We are of the opinion that the procedure which we followed in the *Pullman* case should be followed here. Illinois has the final say as to the meaning of the ordinance in question. It also has the final word on the alleged conflict between the ordinance and the state Act. *The determination which the District Court, the Circuit Court of Appeals or we might make could not be anything more than a forecast—a prediction as to the ultimate decision of the Supreme Court of Illinois.* Here, as in the *Pullman* case 'a federal court of equity is asked to decide an issue by making a tentative answer which may be displaced tomorrow by a state adjudication.' 312 U. S. at page 500, 61 S. Ct. at page 645, 85 L. Ed. 971. Furthermore, the dispute in its broad reach involves a question as to whether a city has trespassed on the domain of a State. Though that issue was not in the case when the complaint was filed, it emerged, due to the passage of the Milk Pasteurization Plant Law, long before the District Court entered its decree. *The*

delicacy of that issue and an appropriate regard 'for the rightful independence of state governments' (Beal *v.* Missouri Pacific R. Co., 312 U. S. 45, 50, 61 S. Ct. 418, 421, 85 L. Ed. 577) re-emphasize that it is a wise and permissible policy for the federal chancellor to stay his hand in absence of an authoritative and controlling determination by the state tribunals. As we said in the *Pullman* case, 'The resources of equity are equal to an adjustment that will avoid the waste of a tentative decision' and any 'needless friction with state policies.' See page 500 of 312 U. S., page 645 of 61 S. Ct., 85 L. Ed. 971, and cases cited; *Thompson* v. *Magnolia Petroleum Co.*, 309 U. S. 478, 483, 484, 60 S. Ct. 628, 630, 631, 84 L. Ed. 876. It is an exercise of a 'sound discretion, which guides the determination of courts of equity.' *Beal* v. *Missouri Pacific R. Co., Supra,* 312 U. S. at page 50, 61 S. Ct. at page 421, 85 L. Ed. 577. In this case that discretion calls for a remission of the parties to the state court which alone can give a definite answer to the major questions posed. *Plainly they constitute the more appropriate forum for the trial of those issues.* See 54 Harv. L. Rev. 1379."

It had been argued before the court that in view of the length of time that the matter had been pending (the litigation commenced shortly after the adoption of the ordinance on January 4, 1935, and the opinion of the United States Supreme Court was delivered on April 27, 1942), and the cost and inconvenience which had already been entailed, the federal courts should proceed to determine the questions of state law. To this the court responded (316 U. S. at p. 173):

"Considerations of delay, inconvenience, and cost to the parties which have been urged upon us, do not

call for a different result. For we are here concerned with *the much larger issue as to the appropriate relationship between federal and state authorities functioning as a harmonious whole.*"

In the *Railroad Commission* v. *Pullman Co.* case, referred to in the foregoing excerpt, the Supreme Court said (312 U. S. at pp. 500, 501):

> "Few public interests have a higher claim upon the discretion of a federal chancellor than the avoidance of needless friction with the state policies * * *. (Citing cases.) These cases reflect a doctrine of abstention appropriate to our federal system whereby the federal courts 'exercising a wise discretion,' restrain their authority because of a '*scrupulous regard for the rightful independence of the state governments*' and for the smooth working of the federal judiciary. See *Cavanaugh* v. *Looney*, 248 U. S. 453, 457; *Di Giovanni* v. *Camden Fire Ins. Asso.*, 296 U. S. 64. This use of equitable powers is a contribution of the courts in *furthering the harmonious relation between state and federal authority* without the need of rigorous congressional restriction of those powers."

The decision in the *Chicago* v. *Fieldcrest Dairies* case, *supra*, is apposite here. If the issue as to the conflict between the Chicago ordinance and the Illinois statute was one of "delicacy," how much more delicate is that as to the constitutionality of a New Jersey statute seeking to forgive obligations to the state of millions of dollars, in alleged violation of a basic fiscal provision of the state constitution.

If the Supreme Court was justified in the *City of Chicago* case in declining to permit federal decision of an issue "by making a tentative answer" as to the state law, and if "the appropriate relationship between federal and state authorities functioning as a harmonious whole" required the disposition there made, consider the shocking disruption of that relationship which may very well eventuate from the course upon which the bankruptcy court has here embarked. Should that court, after hearing the issue, determine that the Settlement Acts are constitutional as to the debtor and that a valid contract exists as between the trustees and the state, and accordingly adjudicate the state's claim on the basis of the Settlement Acts, it would be utterly impossible for the state to avail itself of that decision in view of the final injunction filed in the New Jersey courts preventing the State Treasurer from accepting any principal tax moneys under and pursuant to the Settlement Acts. Not only under the Settlement Acts, but under the laws of the state governing the duties and obligations of the State Treasurer generally, R. S. 52:18-1, *et seq.*, he is the only officer who can accept and transmit moneys into the State Treasury. He is, moreover, a constitutional officer (N. J. Const., Art. VII, Sec. 2, Par. 2).

The sad spectacle of the conflict between federal and state authority which would result from such a determination by the federal court cannot be justified on the basis of any theoretical discussion by the trustees as to the supposed conclusiveness against the state of such a federal adjudication. Apart from the serious legal doubts attending such a conclusion, there would remain in any event a most regrettable disruption of the "appropriate relation-

ship between federal and state authorities functioning as a harmonious whole."

In the *City of Chicago* case, as here, a state court determination intervened pending the federal proceedings. If the trustees correctly contend that the New Jersey decree does not conclude them, neither did the Illinois decree conclude the respondent in the *City of Chicago* case. The litigant affected by the Illinois state case was, moreover, not the same litigant as was prosecuting the federal proceedings, but only a related corporation. Compare the trustees' present claim as to the non-conclusiveness of the New Jersey litigation as to them. There can be no reasonable dispute that the procedure suggested by the Attorney General and by the City of Jersey City would lead to a consideration by the New Jersey courts of the specific contentions made by the trustees, with the result that a determination by those courts in favor of the trustees would permit such opening or modification of the state court injunction as would make possible an effectuation of the determination without any conflict between state and federal jurisdictions. (See Point IV hereinafter.)

That we are here confronted with a railroad reorganization under Section 77 does not affect the basic principle. The same disposition of a similar problem was made by the United States Supreme Court in a Section 77 railroad reorganization case. *Thompson* v. *Magnolia Petroleum* case, *supra*, (cited in the *City of Chicago* case). There the trustees of the railroad petitioned the bankruptcy court to adjudicate the title of the trustees to certain lands whereon its right of way ran, so that they might have the benefit of newly discovered oil fields under the surface. The respond-

ent in that case denied the trustee's title and claimed a prior right under leases from adverse claimants. The district court took jurisdiction and made an order impounding the oil pending its ultimate determination of the question of title. The Circuit Court of Appeals reversed on the ground that under Illinois law the trustees had only an easement and that the bankruptcy court had no summary jurisdiction to determine fee title. The Supreme Court reversed, holding that possession of the land was sufficient to give the bankruptcy court summary jurisdiction to determine title, but that, *as a matter of discretion,* the question of title should be submitted to the Illinois courts. The court said at pp. 483-484:

> "A court of bankruptcy has an exclusive and nondelegable control over the administration of an estate in its possession. But the proper exercise of that control may, where the interests of the estate and the parties will best be served lead the bankruptcy court to consent to submission to state courts of particular controversies involving unsettled questions of state property law and arising in the course of bankruptcy administration. And, under the circumstances of this case, we conclude that it is desirable to have the litigation proceed in the state courts of Illinois. * * *
>
> "Decision with which the Federal Court of bankruptcy is here faced calls for interpretation of instruments of conveyance in accordance with Illinois law. Neither statutes nor decisions of Illinois have been pointed to which are clearly applicable. *And the difficulties of determining just what should be the decision under the law of that state are persuasively indicated by the different results reached by the two Circuit Courts of Appeal that have attempted the determination.* Unless the matter is referred to the

State Courts, upon subsequent decision by the Supreme Court of Illinois it may appear that rights in local property of parties to this proceeding have —by the accident of federal jurisdiction—been determined contrary to *the law of the State which in such matters is supreme.*

"* * * The cause is remanded to the District Court with instructions to modify its order so as to provide appropriate submission of the question of fee simple ownership of the right of way to the Illinois State Courts."

The rationale of the holding quoted is applicable here. The interests not only of the State of New Jersey, but of the debtor, trustee and intervening bondholders, can best be served by the requested reference to the New Jersey courts. A decision there in favor of the position of the trustee would conclusively settle the tax claims of the State of New Jersey in these proceedings, since the requested reference would determine not only the constitutionality of the Settlement Acts as to the debtor (assuming, but not conceding that that question has not already been determined), but also the sufficiency of the tenders by the trustees under the Settlement Acts, and thus terminate the controversy. If, on the other hand, the application of the Attorney General for reference of the question to the state courts is denied and the matter goes forward in the bankruptcy court, there may be one disposition of the questions under the Settlement Acts by the special master, another by the bankruptcy court itself, a rejection of one or the other by the Circuit Court on appeal, and, possibly, another "forecast", "prediction", or "tentative answer" (*City of Chicago* v. *Fieldcrest Dairies, supra,* 316 U. S. at p. 172), by the United States Supreme Court.

Thus, in the event of a conclusion, either by the master or the District Court, in favor of the position of the trustee, and the not unlikely disagreement therein, either by the Circuit Court or this Court, all of the time, effort, and expense to which not only the estate of the debtor, but also the State of New Jersey and the intervening bondholders, would have been put, would be wasted, and the universally desired termination of these reorganization proceedings have been avoidably delayed.

We reserve for discussion in Point III herein the yet additional contingency which might possibly arise to further complicate the proceedings—that somewhere in the train of the federal litigation a "forecast" or "guess" might be made that the Settlement Acts are unavailable to the trustees, thereby necessitating hearings on the alternative contentions made by the trustees respecting the asserted federal constitutional and other objections to the taxes and interest charges.

In *Ford Motor Co.* v. *Department of Treasury of Indiana*, 323 U. S. 459, it was stated at page 470:

> "The advantage of having state courts pass initially upon questions which involve the state's liability for tax refunds is illustrated by the instant case where petitioner sued in a federal court for a refund only to urge on certiorari that the federal court erred in its interpretation of the state law applicable to the questions raised."

See also the reference to "our historic national policy of federal non-interference with the taxing power of states," in *Arkansas Corporation Commission* v. *Thompson*, 313 U. S. 132, 145. Cf. the emphasis upon abstention of

exercise of federal equity jurisdiction where the "collection of state taxes or the fiscal affairs of the state" are involved. *Meredith* v. *Winter Haven, supra* (320 U. S. 228, 235); *Matthews* v. *Rodgers, supra; Great Lakes Dredge & Dock Co.* v. *Huffman, supra; Stratton* v. *St. Louis S. W. R. Co.*, 284 U. S. 521.

The reliance by the trustee upon *Meredith* v. *Winter Haven, supra,* is ineffectual. That case held only that where the jurisdiction of a federal district court was invoked on grounds of diversity of citizenship, it could not decline to exercise its jurisdiction to determine questions of state law merely because they were difficult or uncertain. The court was at pains to cite the cases upon which we have relied hereinabove and many others as representing well defined and recognized situations in which, for reasons of public policy, a federal court will decline to exercise its jurisdiction to pass upon a question of state law. No such public policy was asserted or found to exist in the *Winter Haven* case.

The case of *Public Utility Commission of Ohio* v. *United Fuel Gas Co.*, 317 U. S. 456, also relied upon by the trustee, is not in point. There the court declined to refer a question of state law to the state courts on the ground, *inter alia,* (p. 463) that "no state court ruling of local law could settle the federal questions that necessarily remain." Here, on the contrary, as we have shown above, a state court determination as to the constitutionality and availability of the Settlement Acts to the trustee can, if favorable to the trustee, completely settle the issue as to the New Jersey tax claims. As we shall show in Point III, moreover, such a result would eliminate several questions of *federal*

constitutional law from the controversy. That the disposition of the state tax claims will not dispose of the entire reorganization is, of course, irrelevant, the same situation having obtained in the railroad reorganization case of *Thompson* v. *Magnolia Petroleum Co., supra,* where the court referred one issue arising in the Section 77 reorganization, over which the bankruptcy court had conceded jurisdiction, to the state court for determination.

III.

A reference of the questions of state law to the state courts would eliminate the necessity of deciding federal constitutional qustions on the basis of "preliminary guesses regarding local law."

It is now thoroughly settled that where the determination of a question of constitutional law depends upon the preliminary determination by a federal court of a disputed question of local law, the latter issue will be referred to the state courts to obtain the benefit of an authoritative determination of the local law and thereby possibly eliminate the necessity of deciding the federal constitutional question. *Spector Motor Service* v. *McLaughlin, supra; Chicago* v. *Fieldcrest, supra; Railroad Commission* v. *Pullman Co., supra.* And see *Meredith* v. *Winter Haven, supra* (320 U. S. at 235).

That situation is squarely presented here. The trustee contends before the district court that if the applicability of the Settlement Acts is determined adversely to his position, the New Jersey taxes are objectionable as in vio-

lation of the due process and equal protection clauses of the 14th Amendment (R. 84, par. 5, 73, 74), and the Interstate Commerce and Bankruptcy clauses of Article I, Section 8 of the Federal Constitution (R. 74, 75). It is also claimed, in such event, that there would be an unconstitutional impairment by the state of a valid contract between it and the trustees (R. 60, par. 60). *None of these constitutional questions would require determination in the event that the New Jersey courts, on the requested reference, determine that the Settlement Acts are valid as to the trustees and that a valid contract has arisen settling the amount of the tax claim against the debtor.* The making of that determination involves decision of matters of New Jersey law in the following respects:

1. Whether the determination of the New Jersey Court of Errors and Appeals in *Wilentz* v. *Hendrickson, supra,* that the Settlement Acts offend the New Jersey Constitution, is specifically sound as to the alleged contract between the state and the trustees of the Central Railroad Company of New Jersey, notwithstanding the contentions to the contrary advanced by the trustee in the bankruptcy court (R. 43, *et seq.*).

2. Whether, assuming a valid and constitutional offer was made by the state in the Settlement Acts, the trustees of the railroad strictly complied therewith by agreeing, as required in the Settlement Acts, to pay the full amount of the principal taxes assessed for the years 1932-1940, inclusive. P. L. 1942, Ch. 241, Sec. 2. This issue arises because the amount the railroad agreed to pay is less than what the Attorney General now claims as the principal tax balances due for the years in question, a difference which

stems from conflicting views as to the law of New Jersey in respect of the proper method of appropriating payments on account of arrears of taxes between principal of taxes and accrued interest thereon. The trustee contends that its principal tax obligation due at the time of the adoption of the Settlement Acts, for the years 1932 to 1939, inclusive, was $12,117,383.92 (R. 84, par. 2). The contention of the Attorney General is that the principal tax balance for those years was $14,140,887.53 (R. 94). For the latest expression with respect to the law of New Jersey as to the proper method of appropriating partial payments on account, to railroad taxes and interest in arrears, see *State* v. *Erie Railroad Company*, 23 N. J. Misc. 203, 42 Atl. (2d) 759. This question was adverted to, but found unnecessary to decide in *Wilentz* v. *Hendrickson, supra,* (135 N. J. Eq. at p. 247).

In the *Spector Motor Service* case, *supra,* an action was brought in a federal district court to enjoin the enforcement of a state tax as allegedly violative of the Interstate Commerce clause. The district court construed the statute as not intended to apply to interstate commerce and, therefore, not applicable to the petitioner, which did only interstate business. The Circuit Court of Appeals construed the statute as applicable to petitioner and held that, as so construed, it violated neither the Connecticut nor the federal Constitutions. On certiorari the United States Supreme Court stated that the federal constitution issues did not "emerge until all other local Connecticut issues are decided against the petitioner" (323 U. S. at p. 104). The court went on to conclude that since the State of Connecticut made available an action for declaratory judgment for the determination of the issues of Connecticut law involved,

the cause should be remanded to the district court with directions to retain the appeal, "pending the determination of proceedings to be brought with reasonable promptitude in the state court" (323 U. S. 106). It is noteworthy that this disposition was made by the court on its own initiative, *without any application therefor by the parties.* The language of the court is so perfectly dispositive of the issue involved here that we quote the court's reasoning at length (pp. 104-105):

> "* * * it is for Connecticut to decide from what aspect of interstate business she seeks an exaction. It is for her to say what is the subject matter which she sought to tax and what is the calculus of the tax she seeks. *Every one of these questions must be answered before we reach the constitutional issues which divided the court below.*
>
> "Answers to all these questions must precede consideration of the Commerce Clause. To none have we an authoritative answer. Nor can we give one. *Only the Supreme Court of Errors of Connecticut can give such an answer.* But this tax has not yet been considered or construed by the Connecticut courts. We have no authoritative pronouncements to guide us as to its nature and application. That the answers are not obvious is evidenced by the different conclusions as to the scope of the statute reached by the two lower courts. The Connecticut Supreme Court may disagree with the District Court and agree with the Circuit Court of Appeals as to the applicability of the statute. But this is an assumption and at best 'a forecast rather than a determination.' *Railroad Commission* v. *Pullman Co.*, 312 U. S. 496, 499, 85 L. Ed. 971, 974, 61 S. Ct. 643. *Equally are we without power to pass definitely on the other claims urged under Articles 1 and 2 of the Connecticut Constitu-*

tion. If any should prevail, our constitutional issues would either fall or, in any event, may be formulated in an authoritative way very different from any speculative construction of how the Connecticut courts would view this law and its application. *Watson* v. *Buck,* 313 U. S. 387, 401, 402, 85 L. Ed. 1416, 1423, 1424, 61 S. Ct. 962, 136 A. L. R. 1426.

"If there is one doctrine more deeply rooted than any other in the process of constitutional adjudication, it is that we ought not to pass on questions of constitutionality—here the distribution of the taxing power as between the State and the Nation—unless such adjudication is unavoidable. And so, as questions of federal constitutional power have become more and more intertwined with preliminary doubts about local law, *we have insisted that federal courts do not decide questions of constitutionality on the basis of preliminary guesses regarding local law. Railroad Commission* v. *Pullman Co.,* 312 U. S. 496, 85 L. Ed. 971, 61 S. Ct. 643, *supra; Chicago* v. *Fieldcrest Dairies,* 316 U. S. 168, 86 L. Ed. 1355, 62 S. Ct. 986; *Re Central R. Co.,* (C. C. A. 3d) 136 F. (2d) 633, 54 Am. Bankr. Rep. (N. S.) 101. See also *Burford* v. *Sun Oil Co.,* 319 U. S. 315, 87 L. Ed. 1424, 63 S. Ct. 1098; *Meredith* v. *Winter Haven,* 320 U. S. 228, 235, 88 L. Ed. 9, 13, 64 S. Ct. 7; *Green* v. *Phillips Petroleum Co.,* (C. C. A. 8th) 119 F. (2d) 466; *Findley* v. *Odland,* (C. C. A. 6th) 127 F. (2d) 948; *United States* v. *150.29 Acres of Land More or Less,* (C. C. A. 7th) 135 F. (2d) 878. Avoidance of such guesswork, by holding the litigation in the federal courts until definite determinations on local law are made by the state courts, merely heeds this time-honored canon of constitutional adjudication.

"We think this procedure should be followed in this case."

In *Chicago* v. *Fieldcrest Dairies, supra,* discussed at length in Point II, as an additional ground for the determination of the court that the issues of Illinois law should be referred to the Illinois courts, the court said (316 U. S. at p. 173):

> "It is of course true that respondent sought to raise in its complaint a constitutional issue—an issue which lurks in the case even though it not be deemed substantial. But here, as in the *Pullman Co.* case, *that issue may not survive the litigation in the state courts.* If it does not, the litigation is at an end. That again indicates the wisdom of allowing the local law issues first to be resolved by those who have the final say. *Avoidance of constitutional adjudications where not absolutely necessary* is part of the wisdom of the doctrine of the *Pullman Co.* case."

In *Railroad Commission of Texas* v. *Pullman Co., supra,* cited in the foregoing cases there was before the Supreme Court on appeal a federal district court determination that an order by the Railroad Commission of Texas was violative of Texas statute and subject to injunction because in conflict with the equal protection and due process clauses of the 14th Amendment and the commerce clause of the Federal Constitution. The United States Supreme Court reversed the judgment, saying (312 U. S. at p. 499)

> "Reading the Texas statutes and the Texas decisions as outsiders without special competence in Texas law, we would have little confidence in our independent judgment regarding the applicability of that law to the present situation."

Then, conceding the competency in Texas law of the federal district court judges, the Supreme Court went on to say (pp. 499-500):

> "But no matter how seasoned the judgment of the district court may be, *it cannot escape being a forecast rather than a determination. The last word on the meaning of* • • • *the Texas Civil Statutes* • • • *belongs neither to us nor to the district court, but to the Supreme Court of Texas.* In this situation a federal court of equity is asked to decide an issue by making a tentative answer which may be displaced tomorrow by a state adjudication. *Glenn* v. *Field Packing Co.*, 290 U. S. 177; *See* v. *Bickell*, 292 U. S. 415. The reign of law is hardly promoted if an unnecessary ruling of a federal court is thus supplanted by a controlling decision of a state court. *The resources of equity are equal to an adjustment that will avoid the waste of a tentative decision as well as the friction of a premature constitutional adjudication.*"

And at page 501:

> "Regard for these important considerations of policy in the administration of federal equity jurisdiction is decisive here. *If there was no warrant in state law for the Commission's assumption of authority there is an end of the litigation; the constitutional issue does not arise.*"

So, too, here. If the state courts shall determine the issues arising out of the Settlement Acts favorably to the trustee, and accordingly lift the pending state court injunction, as only they can, so as to make possible the effectuation of the thus conclusively determined settlement of the

state tax claims, "there is an end of the litigation" and the alternative constitutional issues raised by the trustee here do not arise.

IV.

The Uniform Declaratory Judgments Act is law in New Jersey and makes available a determination of the issues sought to be referred to the state courts.

In the several United States Supreme Court decisions above referred to, where issues of state law were directed to be referred to the state courts, it was generally assumed that the state laws made available procedure for the determination of the questions. Certainly, the appropriate exercise of federal discretion, as contended for here, should not be declined unless it is plain that no procedure exists whereby the New Jersey courts could dispose of the questions presented. In *Spector Motor Service* v. *McLaughlin, supra,* however, the court pointed out the availability of an action for declaratory judgment under the Connecticut statutes. So, too, under the New Jersey law. New Jersey has adopted the *Uniform Declaratory Judgments Acts* (R. S. 2:26-66, *et. seq.*).

We respectfully submit that the situation here presented is such as represents the very type of controversy peculiarly adapted to the procedure under the uniform act, and for the handling of which the act was devised. It is inconceivable that the New Jersey courts would decline to entertain a proceeding brought under its terms in the New Jersey Court of Chancery by the Attorney General of the state,

reciting (a) the earlier proceedings in that court in *Wilentz v. Hendrickson, supra,* (b) the controversy raised by the trustee in these proceedings respecting the validity and applicability of the Settlement Acts as to him, and (c) a direction by this Court that the Attorney General be granted permission to join the trustee as a party defendant in such state court proceedings, entered for the purpose of obviating any possibility of a conflict between a federal court adjudication of the existence of a binding contract between the state and the trustee based upon the Settlement Acts and the permanent injunction against enforcement of the acts and acceptance of any moneys thereunder now filed in the Court of Chancery against the State Treasurer.

Although the New Jersey cases have held that the remedy of declaratory judgment is not available where there is another remedy for the specific injury complained of, the present situation plainly is one where no other remedy can meet the anticipated specific conflict between federal and state adjudications and decrees above referred to.

In *Empire Trust Co.* v. *Board of Commerce and Navigation,* 124 N. J. L. 406, 411, 11 Atl. (2d) 752, the New Jersey Supreme Court stated:

> "The Declaratory Judgments Act is designed to provide a remedy for the adjudication of justiciable rights, duties, status and other legal relations of the parties before rights have been invaded or wrongs committed. * * * The declaratory judgment was intended to modify the common law rule that there is no justiciable controversy until a right has been invaded."

Plainly, that reasoning applies here. The purpose of the Attorney General's application below and of our pres-

ent contention here is to secure such a determination of the rights and obligations of the trustee and the state under the Settlement Acts, if any, as will permit any such adjustment of the existing Chancery Court injunction against the State Treasurer as may be necessary to accord with the conclusion of the court on the merits of the controversy and protect all parties in interest in advance of the invasion of any right or the commission of any wrong. The action would be brought by the Attorney General, as successor in interest to the former Attorney General who was the informant in *Wilentz* v. *Hendrickson, supra.*

It is inconceivable that the state courts would, upon the foregoing showing, decline to exercise jurisdiction under the act to afford the declaratory and supplemental relief requested. There is a wealth of judicial authority for the submission by a state attorney general or similar officer of comparable issues for determination under a declaratory judgments statute. *State ex rel. Hopkins* v. *Grove,* 109 Kans. 619, 201 Pac. 82; *Jefferson County Fiscal Court* v. *Jefferson County, ex rel. Grauman, county attorney,* 278 Ky. 785, 129 S. W. 2d 554; also case of same name, 278 Ky. 68, 128 S. W. 2d 230; *Jones, Attorney General* v. *Vermont Asbestos Corp.,* 108 Vt. 79, 182 Atl. 291; *State, ex rel. Eubanks* v. *Board of Commissioners, et al.,* 150 Kans. 143, 91 P. 2d 2; *Attorney General* v. *Racecourse Betting Control Board* (1935), 1 Ch. 34; *Lynn* v. *Kearney County,* 121 Neb. 122, 236 N. W. 192; *Ward* v. *Klamath County,* 108 Ore. 574, 218 Pac. 927.

The use of the Declaratory Judgment procedure by administrative governmental agencies to settle both private and public rights, duties, and liabilities is universally rec-

ognized as a most characteristic and appropriate application of the practice. *Borchard, Declaratory Judgments* (2d ed. 1941), pages 155, 520, 875, 884, 885, 915, *et seq.*

If the trustee entertains any doubt, which we do not, as to the availability of a proceeding for the stated purpose under the Declaratory Judgments Act, there can be no question whatever that the New Jersey Court of Chancery would entertain a supplemental civil information filed by the Attorney General, either plenary in form, or addressed to the final decree in *Wilentz* v. *Hendrickson*, laying before the court the matters in question. The Attorney General has frequently expressed his willingness to cooperate with the trustee to the end that the procedure employed in the state courts shall be such as to expedite and assure a solution of the question presented, on its merits.

The offer of cooperation by the attorney general in devising the procedure for submission of the questions to the state courts insures that no procedural obstacle will arise to block this expeditious means of solution of the Settlement Act controversy.

Conclusion.

For the reasons hereinabove stated, it is respectfully submitted:

1. The judgment of the Circuit Court of Appeals should be affirmed for the reason that the bankruptcy court is without jurisdiction to entertain the claim of the trustee for specific performance of the Settlement Act contract against the State of New Jersey without its consent.

2. In the alternative, the Court should direct that the bankruptcy court submit to the courts of New Jersey for determination all questions as to the constitutionality and applicability as to the trustee of the Settlement Acts (P. L. 1941, Ch. 290 and P. L. 1942, Ch. 241).

Respectfully submitted,

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Of Counsel.

FILE COPY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1946

No. 92

WALTER P. GARDNER, Trustee of the Central Railroad Company of New Jersey,

Petitioner,

vs.

STATE OF NEW JERSEY,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

REPLY BRIEF OF GROUP OF INSTITUTIONAL INVESTORS, WATTERS COMMITTEE OF BONDHOLDERS, BROOKS COMMITTEE OF BONDHOLDERS AND CENTRAL HANOVER BANK & TRUST COMPANY AS *AMICI CURIAE*

FRED N. OLIVER
WILLARD P. SCOTT
THOMAS RAEBURN WHITE
WILLIAM A. ROBERTS
PHILIP S. JESSUP
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December 17, 1946.

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Preliminary Statement

This reply brief is directed solely to a question interjected by the State in its brief which is inappropriate for consideration at this time. That question is whether or not the State's claim, if any, may be ultimately satisfied by the issuance of securities in a plan of reorganization. We believe that the State's position with respect to that question is unsound and that Section 77 of the Bankruptcy Act clearly authorizes the issuance of securities in reorganization for satisfaction of state claims under the proper

circumstances. However, we believe this to be an inappropriate time to argue that question for the reasons that not only is that question irrelevant to the issues before this Court in this proceeding but it is a wholly hypothetical one that should not and cannot be passed on by the Court at this time.

I.

The Question Is Wholly Irrelevant to the Issues Before the Court

The question of the manner in which the State's unpaid claim, if any, is to be satisfied has no bearing upon the question of the proper forum for determining the amount of the State's claim or the legal principles applicable in making that determination. If it be determined that the State has any remaining unsatisfied claim, the question of how that claim is to be ultimately paid involves wholly different considerations from those bearing upon the questions of by whom and with respect to what legal principles the adjudication of the claim shall be had.

The question of the *adjudication* of the State's claim involves certain legal questions that have been discussed in our main brief and in the main brief of the Trustee of the Debtor. On the other hand, the question of the *payment* of the State's claim, if any, involves certain practical problems, such as the sufficiency of the assets to pay the claim; what assets may be made available to pay it without destroying the public service rendered by the carrier; and other similar questions, each of which must be viewed in the light of all the relevant facts.

We think it clear that this question is no more relevant to a determination of the pending issues than would be a

determination at this time of any one of a number of questions that might conceivably arise out of the possible means of satisfying the State's claim, if any.

II.

The Question Interjected by the State Is Wholly Hypothetical and Cannot Be Properly Decided at This Time

The question of whether the State may be required to accept bonds for satisfaction of its claim, if any, is not now before the Court and may never arise. If it is ultimately determined that the State has no additional claim, the question clearly cannot arise.

On the other hand, even if the State is ultimately found to have an additional claim secured by a prior lien, or otherwise entitled to priority, that claim may be in an amount which could be satisfied out of cash on hand and consequently the question raised by the State need never be determined. As recognized by the State in its brief (p. 52), this Court has always refused to give advisory opinions or pass upon questions that are not involved in the issues before it.

Not only is the question hypothetical but its ultimate determination, if required, is dependent upon important questions of fact that do not appear of record here, for the reason that it was never contemplated that such an issue would be raised in this proceeding. In addition to the absence of any factual record, there are also lacking the requisite determinations by the Interstate Commerce Com-

mission that are essential in passing upon questions involving public service provided by interstate carriers and problems of capitalization. These determinations must be made before any decision can properly be made by this Court.

For example, should it become necessary to satisfy any additional prior lien claim of the State, the cash on hand may have to be allocated as between the payment of such a claim and the reservation of sufficient working capital to continue essential operations. Such a determination calls for the exercise of the expert and informed judgment of the Interstate Commerce Commission. On the other hand if no cash is available for satisfaction of such a claim, the question arises whether the State should be permitted to foreclose its lien, liquidate the property and terminate the operations of an interstate carrier. If it is not to be permitted to do this, a further question may arise as to what, if any, assets are available for liquidation and how they are to be liquidated. Or, if no assets are available for liquidation, what other means, such as issuing securities of a reorganized company, is available for satisfaction of such a claim. Moreover, if securities are the only possible means of satisfying such a claim without complete cessation of public service, the question arises as to what type of securities can be given to the State that will be compatible with the continuance of the Debtor's public service.

All of these questions depend on the basic questions of the public interest and the value of the properties involved,

which the Interstate Commerce Commission is the appropriate and the designated tribunal to determine. All of them involve a determination of a multitude of facts which are not of record and cannot be of record until the issue is properly presented at an appropriate phase of the reorganization proceeding. All of them call for the exercise of the expert and informed judgment of the Commission, which this Court has found requisite in dealing with similar problems in other railroad reorganizations.

In one of its most recent decisions, *Thompson v. The Texas Mexican Ry. Co.*, 90 L. ed. 886, 896, decided April 29, 1946, this Court said:

> "Thus, however the case may be viewed, the court below should have stayed its hand and remitted the parties to the Commission for a determination of the administrative phases of the questions involved. Until that determination is had, it cannot be known with certainty what issues for judicial decision will emerge. Until that time, judicial action is premature."

The bald legal question raised by the State cannot be considered apart from the facts out of which it may arise. No opportunity has been given to present those facts and the Interstate Commerce Commission has had no opportunity to appraise them. We respectfully submit that this Court should not attempt to pass on the question thus interjected by the State, until such time, if ever, as the question may properly come before it.

Conclusion

For the reasons set forth above we urge that the Court refrain from expressing any views with respect to the question of whether or not the State's claim may ultimately be satisfied by the issuance of securities in a plan of reorganization.

Respectfully submitted,

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December 17, 1946.

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CHARLES ELMORE CROPLEY

IN THE

Supreme Court of the United States

OCTOBER TERM — 1945

No. 1143

WALTER P. GARDNER, Trustee of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY,

A Debtor-Petitioner,

vs.

THE STATE OF NEW JERSEY,

A Creditor.

PETITION FOR RECONSIDERATION OF TRUSTEE'S PETITION FOR A WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

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PETITION FOR RECONSIDERATION OF TRUSTEE'S PETITION FOR A WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

To the Honorable Justices of the Supreme Court of the United States:

The petition of WALTER P. GARDNER, surviving trustee of The Central Railroad Company of New Jersey, a debtor corporation in bankruptcy under Section 77 of the Bankruptcy Act, for a reconsideration of the Petition for a Writ of Certiorari to the Circuit Court of Appeals for the Third Circuit, which was denied by the Court on May 20, 1946, respectfully shows and charges as follows:

First: **This case involves important questions of Federal law which have not been, but should be, settled by this Court.**

The petitioning railroad being one of the Trunk Line carriers serving the Port of New York constitutes a vital part of the national transportation system. It has been in reorganization under Section 77 of the Bankruptcy Act for over six years. The chief claimants against the Debtor's Estate are the State of New Jersey and the First Mortgage Bondholders, both of whom have filed proofs of claim in the Debtor's reorganization proceedings, and both assert liens as security for said claims, which liens are conflicting.

In this situation the Trustees of the Debtor's Estate, notwithstanding the most assiduous and continuous efforts during the past six years, have been unable to secure a judicial determination as to the extent and priority of the aforesaid liens, and the surviving Trustee is now confronted by a decision of the Third Circuit Court of Appeals which purports to follow the decision of this Court in *Arkansas Corporation Commission* v. *Thompson*, 313 U. S. 132, and which, based upon said Court's construction of that decision, excludes from the jurisdiction of the Bankruptcy Court any questions regarding a railroad debtor's liability for State taxes, except those involving (1) mathematical error in computation or (2) legal error in the tax assessment. Such a construction of the bankruptcy power precludes any judicial determination as to either the extent or the priority of the tax liens now asserted by the State of New Jersey against the Debtor's Estate, and creates an insuperable barrier to any progress in the Debtor's reorganization.

A controlling reason why this case merits review by this Honorable Court is that the stalemate above described appears to be directly traceable to the uncertainty that has arisen as the result of the decision of this Court in the Arkansas Commission case respecting the

scope of the bankruptcy jurisdiction in dealing with State tax claims. Respecting this uncertainty, Collier, in his 14th Edition of his work relating to Bankruptcy, Volume 3, page 2164, after quoting extensively from the Arkansas Commission decision, has this to say:

> "The effect of this decision upon the former doctrines concerning the Bankruptcy Court's power to determine the amount and legality of taxes is obviously far-reaching. Yet the full extent of this effect is somewhat in doubt."

In a footnote at the bottom of page 2166, the same work, he says:

> "It is regrettable that the Supreme Court took such an inapt case as the occasion to express its views as to the second proviso of Section 64 A 4 under the fact situation and in the light of the propositions previously set forth herein the decision is not directly in point on the problem of pre-bankruptcy assessments by tax officials, assessors and the like."

Since the Arkansas decision did not involve any question as to the extent or priority of liens or the application of Section 67 b and c to railroads in reorganization under Section 77, it seems doubtful that this Court intended to pass upon such matters; but the fact is that the Third Circuit Court of Appeals in the present case has so construed said decision as to deprive the Bankruptcy Court of the jurisdiction if had asserted to deal with such questions. The result is that unless the lower court's decision is reviewed, and this Court's decision in the Arkansas case is clarified, the petitioner can see no basis on which a plan for reorganizing the Debtor under Section 77 can be devised. It is apparent that if the true meaning of Section 77 is not clarified, the practical working of the whole Congressional Plan for railroad reorganization will be defeated.

Second: **The Third Circuit Court of Appeals in this case has rendered a decision in conflict with the decisions of other Circuit Courts of Appeals.**

The lower court set aside an order of the Bankruptcy Court asserting jurisdiction to pass upon the extent and priority of the tax liens asserted by the State of New Jersey, basing its decision on the ground that "the only matters left open for the Bankruptcy Court to pass upon are: 1. mathematical error in the computation of the amount of the tax or legal error in its assessment." In this respect the decision of said Court appears to be in direct conflict with the decision of the Second Circuit Court of Appeals in *Lyford* v. *New York*, 140 Fed. 2nd 840, wherein it was held that a Bankruptcy Court in administering Section 77 does have jurisdiction to pass upon the extent and priority of State tax claims.

The importance of this question as to the extent and priority of tax liens from the standpoint of the administration of Section 77 generally will be apparent from the fact that if the decision of the Third Circuit Court in the present case stands, it will mean that the extent and priority of a State's tax lien against a railroad in reorganization will be determined by the mere claim of the State as filed in the proceeding and without any adjudication thereof by the Reorganization Court. This necessarily results because there has been no hearing or adjudication of any kind in any court as to the extent and priority of the liens involved.

Third: **The Third Circuit Court of Appeals, in dealing with the Bankruptcy Court's action respecting a compromise of the State's tax claim, has so limited the Bankruptcy Court's jurisdiction as to deprive the Debtor of rights acquired under applicable local decisions.**

A major question that must be settled is whether the very large tax claim which the State of New Jersey filed in the Debtor's reorganization proceeding has been either compromised or modified by intervening equities which have arisen as the result of action taken by the Trustees under the direction of the Bankruptcy Court in the effort to accept the offer contained in a regularly enacted statute of the State of New Jersey, which statute, subsequent to the Trustees' action, was held unconstitutional in a proceeding to which neither the Debtor nor the Trustees were parties.

The Third Circuit Court of Appeals in *In re Central Railroad Company of New Jersey,* 136 Fed. (2d) 633 (Cert. den. in *Pitney et al.* v. *State of New Jersey,* 320 U. S. 805, No. 534, October Term 1943) held that the order of the Bankruptcy Court directing the Trustees to accept said offer of compromise was in part invalid, but the question as to what rights or equities the Debtor's Estate might have acquired as the result of the Trustees' bona fide effort to accept the State's offer of compromise was not in issue and was not decided. (State's Brief, pp. 8, 9, 13, 14, 18 in *Pitney* v. *State of New Jersey,* 320 U. S. 805.) Furthermore, that question was not in issue in the proceeding before the Third Circuit Court which is the subject of this petition. The decision of that Court here involved, however, by its terms excludes consideration of that question from the jurisdiction of the Bankruptcy Court. In this respect, said decision is highly prejudicial, since under the law of New Jersey it is settled that a statute held unconstitutional is not necessarily void ab initio, *Allison* v. *Corker,* 67 N. J. L. 596; *Lang* v.

Bayonne, 74 N. J. L. 455; *Attorney General* v. *McGuinness*, 78 N. J. L. 346; *Eastwood* v. *Russell*, 81 N. J. L. 672; *In re Public Utility Board*, 83 N. J. L. 303, and by the decision of this Court in *Chico County Drainage District* v. *Baxter State Bank*, 308 U. S. 371-374. The Debtor's Estate is entitled to a judicial determination as to whether it has not acquired rights or equities as the result of its acceptance of the offer of compromise, while it was a valid and subsisting offer notwithstanding a subsequent determination that the statute containing said offer was, as to certain parties, unconstitutional.

Fourth: **The very unusual developments since our original petition for a writ of certiorari was filed call for a reconsideration thereof.**

The original petition for a writ of certiorari was filed on April 18, 1946. In the State's "Brief in Opposition to Petition for Writ of Certiorari" (p. 4) it is stated that:

> "The Trustee since the filing of present petition for certiorari has made a substantial part payment on the tax debt, reserving all rights to continue litigation."

In order that this Court may be accurately informed respecting the significance of this payment, we attach hereto Order No. 333 of the Reorganization Court authorizing the payment on conditions approved by the Attorney-General of the State of New Jersey. The Court's attention is invited to the fact that this large cash payment was made by the Trustee with the consent of the State, subject to the express proviso that the application of the payment might become subject to final determination by the Reorganization Court, although in the absence of a review of the Third Circuit Court's decision by this Court, the jurisdiction of the Reorganization Court in the premises will be wholly uncertain.

If the payment in question is ultimately determined to apply in discharging the principal of taxes claimed by the State and interest at 3% per annum to date of payment, then the balance of the State's claim, amounting to over Sixteen Million Dollars, will represent only penalties claimed at 1% per month.

WHEREFORE, your petitioner prays that the Court reconsider our petition that a writ of certiorari may issue out of this Court to the United States Circuit Court of Appeals for the Third Circuit, commanding said Court to certify and send to this Court on a day to be determined, the full and complete transcript of the record of all the proceedings of such Circuit Court of Appeals had in this case, to the end that the case may be reviewed and determined by this Court; that the judgment of the Circuit Court of Appeals be reversed, and that petitioner be granted such other and further relief as may be proper.

Dated, May 21, 1946.

WALTER P. GARDNER,
Surviving Trustee of The Central Railroad Company of New Jersey, The Debtor,

By JAMES D. CARPENTER, JR.,
HOWARD L. KERN,
ALEXANDER H. ELDER,
Attorneys for Petitioner,
75 Montgomery Street,
Jersey City 2, New Jersey.

CERTIFICATE OF COUNSEL

I, JAMES D. CARPENTER, JR., attorney appointed by the District Court for Walter P. Gardner, Trustee of The Central Railroad Company of New Jersey, do hereby certify that the foregoing petition is filed in good faith and not for delay.

Dated, May 21, 1946.

JAMES D. CARPENTER, JR.

IN THE

DISTRICT COURT OF THE UNITED STATES

FOR THE DISTRICT OF NEW JERSEY

In the Matter of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY, *Debtor.*	In Proceedings for the Reorganization of a Railroad. No. 29,778.

Order No. 333 Authorizing and Directing Trustee to Make Payment on Account of Taxes Claimed by State of New Jersey

This cause coming on to be heard pursuant to order entered herein on April 16, 1946, and it appearing to the Court that due notice of said order and of the hearing thereon has been served as said order directed and the Court having reviewed the record and having heard the parties and being fully advised in the premises, it is

ORDERED, ADJUDGED and DECREED:

1. The Trustee is hereby authorized and directed to pay to the State of New Jersey within 10 days the sum of $15,250,000.00 in cash on account of tax claims of the State of New Jersey for the years 1932 to 1940, inclusive, including interest thereon, if any, said payment to be made upon the following conditions, to which the State of New Jersey, by acceptance of said payment, shall be deemed to have expressly assented:

(a) in the event that the claims of the State of New Jersey shall be finally determined to be an

amount greater than said payment, said payment shall be deemed to have been applied in satisfaction of said claims, as finally determined, for each of the years commencing with 1940 and extending back through each of the preceding years and portion thereof that said payment shall be sufficient therefor, *provided* that with respect to any year for which such payment shall be sufficient to satisfy only a portion of the claim the application shall be deemed to have been made ratably as between the principal amount of the tax and the interest thereon, at the rate finally determined, computed to the date of said payment; and provided further, that if it shall be finally determined that this Court may direct the application of said payment solely to the satisfaction of the principal amount of said claims, the application of said payment shall be deemed to have been made solely in satisfaction of said principal amount;

(b) in the event that the claims of the State of New Jersey shall be finally determined to be an amount less than said payment, the amount of such overpayment shall be credited by the Treasurer of the State of New Jersey upon the taxes next legally levied and payable to the State of New Jersey, subsequent to such determination, by the Trustee or the Debtor or any successor in title to substantially all of the properties of the Debtor located in the State of New Jersey;

(c) in making said payment the Trustee may, in his discretion, use the funds represented by certified checks in the aggregate amount of $3,577,689.52 payable to the Treasurer of the State of New Jersey, and tendered to said Treasurer pursuant to Orders Nos. 123, 163, 178 and 216 entered

herein, and for that purpose may regain possession of and surrender said checks for cancellation, without prejudice to effectiveness of said tenders or any other tenders or the legal consequences that may be found to have ensued therefrom.

2. Except as otherwise provided in paragraph 1 of this order, the making of said payment by the Trustee and the acceptance thereof by the State of New Jersey shall be without prejudice to the rights of or the positions asserted by either of them or any party hereto in litigation now or hereafter pending relating to said claims of the State of New Jersey.

GUY L. FAKE
United States District Judge

Dated: April 26th, 1946.

The making and entry of the
foregoing order is hereby approved.

WALTER D. VANRIPER
Attorney General
of New Jersey
by Benj. C. Van Tine
Deputy Attorney General

FILE COPY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1946
No. 92

WALTER P. GARDNER, Trustee of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY,

Petitioner,

vs.

STATE OF NEW JERSEY,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

PETITION OF STATE OF NEW JERSEY FOR REHEARING.

WALTER D. VAN RIPER,
Attorney-General of New Jersey,
Attorney for Respondent,
State House, Trenton, N. J.

BENJAMIN C. VAN TINE,
Of Counsel.

February 10, 1947.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1946

No. 92

WALTER P. GARDNER, Trustee of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY,

Petitioner,

vs.

STATE OF NEW JERSEY,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

PETITION OF STATE OF NEW JERSEY FOR REHEARING.

To the Honorable Justices of the Supreme Court of the United States:

The petition of the State of New Jersey, respondent in the above-entitled cause, respectfully prays for a rehearing in the said cause for the reasons hereinafter shown. Judgment was rendered in the said cause on January 20, 1947.

I.

Your petitioner respectfully shows that there was no "lien of a State" for taxes within the issues of *VanHuffel* vs. *Harkelrode*, 284 U. S. 225.

This Court apparently laid considerable stress on *VanHuffel* vs. *Harkelrode*, *supra*, to support the proposition that the bankruptcy court has certain broad powers with respect to the pre-existing "lien of a State" for taxes. Reference to the record in that case discloses that it was not taxes due a State but taxes due to Trumbull County, Ohio, that were in issue. The words "states taxes" were used in the sense that it has often been said that all taxes are state taxes for the reason that they can be levied only by authority of State law. Your petitioner begs leave to present to this Court the true facts of this case.

Since *VanHuffel* vs. *Harkelrode*, *supra*, dealt only with taxes due a county, it could be of no help whatsoever in the determination of the question of a State's immunity from process with respect to pre-existing tax liens. Concerning the question of immunity, your petitioner respectfully calls to the attention of this Court, that this Court has long since held that there is a distinction between a State and the subdivisions thereof with respect to such immunity.

In *Hopkins* vs. *Clemson College*, 221 U. S. 636, 645, this Court said:

> "In *County of Lincoln* vs. *Luning*, 133 U. S. 529, 530, the court said that: 'While a county is territorially a part of the State, yet politically it is also a corporation, created by and with such powers as are given to it by the State. In this respect it is a part of the State only in that remote sense in which any city, town, or other municipal corporation may be said to be a part.' The court there held that the Eleventh Amendment

was limited to those cases in which the State is the real party, or party on the record, but that counties were corporations which might be sued."

The only question involved in the *VanHuffel* case was the very limited question concerning the power of the Bankruptcy Court to transfer the lien for taxes to the proceeds of the sale where the court otherwise had jurisdiction of the parties. The *VanHuffel* case is reported in *American Law Reports*, 78 A. L. R. 453. The annotation on page 458 is illuminating:

"This annotation is supplemental to that in 35 A. L. R. 255.

"The rule stated in the earlier annotation, that a court of equity may under proper circumstances order a sale by the receiver of the property being administered upon, free from liens, and remit the lienor to the proceeds, is supported by the more recent decision in *Davis* vs. *Patterson* (1930) 180 Ark. 918, 25 S. W. (2d) 452, in which it was said: 'The parties all being before the court, it had the right to order a sale of the property free of all claims, liens, and encumbrances for disposition of the proceeds among the parties entitled thereto upon proper adjudication of their rights.'"

That Mr. Justice Brandeis, who wrote the opinion in the *VanHuffel* case, also believed this to be the rule of that case is shown by *Louisville Bank* vs. *Radford*, 295 U. S. 555, wherein the eminent Justice said for this Court, at page 583:

"Bankruptcy acts had, either expressly, or by implication, as was held in *VanHuffel* vs. *Harkelrode*, 284 U. S. 225, 227, authorized the court to direct, in the interest of other creditors, that all liens upon prop-

erty forming a part of the bankrupt's estate be marshalled; that the property be sold free of encumbrances; and that the rights of all lienholders be transferred to the proceeds of the sale—a power which 'had long been exercised by federal courts sitting in equity when ordering sales by receivers or on foreclosure.' *First National Bank* vs. *Shedd*, 121 U. S. 74, 87; *Mellon* vs. *Moline Malleable Iron Works*, 131 U. S. 352, 367. Compare *Ray* vs. *Norseworthy*, 23 Wall. 128, 135. But there had been no suggestion that such a sale could be made to the prejudice of the lienor, in the interest of either the debtor or of other creditors. By the settled practice, a sale free of liens will not be ordered by the bankruptcy court if it appears that the amount of the encumbrance exceeds the value of the property."

And at page 589:

"The bankruptcy power, like the other great substantive powers of Congress, is subject to the Fifth Amendment."

Ray vs. *Norseworthy*, *supra*, and the *Louisville Bank* case were cited by the State in its original brief.

II.

Your petitioner respectfully shows that *New York* vs. *Irving Trust Company*, 288 U. S. 329, was not concerned with pre-existing liens of a State for taxes.

The sole question involved in the *Irving Trust Company* case was the power of the Court to issue a bar order compelling a State to make proof of claim under Section 64 of the bankruptcy act or be forever barred from any share

in the assets available for unsecured creditors. This Court said, at page 331:

> "It is admitted here, that as the United States and the States are not mentioned in the limitation of § 57, they are not bound thereby The consequent necessity for bar orders is apparent. Otherwise, estates could not be promptly closed." (Citing cases.)

Your petitioner is unable to find of record any case wherein bar orders were used for any purpose except to wipe out claims against assets available for distribution to general unsecured creditors. Your petitioner sought to show in detail in its original brief that Section 64 is in no wise applicable to pre-existing liens. The State's argument stands unchallenged.

In this connection your petitioner begs leave to re-argue the point whether, if there was any inherent power in the Bankruptcy Court to hear questions concerning the legality of taxes, why Congress should have deemed it necessary to grant specific power to the Bankruptcy Court to determine the amount and validity of wholly unsecured taxes claiming the grace of priority under Section 64.

In connection with this case, your petitioner respectfully inquires why if the State is a creditor in the broad sense held by this Court in its opinion, the said State should be permitted to participate in creditors' meetings only in the qualified manner prescribed by Section 57e.

III.

Your petitioner respectfully shows that *VanHuffel* vs. *Harkelrode, supra,* and *New York* vs. *Irving Turst Co., supra,* are not authority for the rule stated by this Court to the effect that in bankruptcy cases "the authority of the Court to deal with the lien of a State has long been recognized."

The above mentioned cases cited by this Court in support of the stated rule do not stand up under scrutiny. Nor is the matter helped in any wise by the rule of *New York* vs. *Maclay*, 288 U. S. 290, and *U. S.* vs. *Texas*, 314 U. S. 480, cited by this Court just before the other two cases. In each of these latter cases the issue was between the United States Government and a State, each claiming certain priorities. But in neither of these cases was the Court concerned with a pre-existing lien of a State for taxes.

The State has never argued that the immunity granted by the 11th Amendment or by the inherent nature of sovereignty has been such as to prevent the United States Government asserting a claim against a State. As to the specific issues of those cases, the taxes due to the State were not liquidated and apparently on this narrow distinction the taxes of the United States were given priority under a specific statute. But as shown at pages 292-293 of the *Maclay* case, the rule stated therein with respect to the claims of the United States does not apply with respect to the claims of a State against private interests.

Your petitioner respectfully submits that the State can show that, even with respect to the claims of the United States, Congress had generally recognized a pre-existing tax lien of a State as being paramount to the lien of the United States for taxes of subsequent years. With respect to the instant matter, your petitioner respectfully submits that a reargument will clearly disclose that none of the cases cited by this Court support the rule stated in its opinion.

IV.

Your petitioner respectfully shows that prior to the passage of Section 77 neither a State nor any other lien claimant was required to file a claim for pre-existing liens or be barred of vested rights in the property of a bankrupt.

Your petitioner respectfully submits that throughout the opinion of this Court there runs the thought that at the time of the passage of Section 77 the rule was clearly established that a State having pre-existing liens for taxes could be compelled to participate in bankruptcy proceedings or be barred from any interest in the liened property.

Your petitioner set forth at length in its original brief the cases supporting the rule that the Bankruptcy Court takes property in the same "plight and condition" in which the bankrupt had it at the time of bankruptcy. This argument has never been answered. Your petitioner has set forth the rule that the bankruptcy power is subject to the due process clause, *Louisville Bank* vs. *Radford, supra.* Your petitioner respectfully asserts that prior to the passage of Section 77, there was no rule or statutory provision whatsoever requiring either a private or governmental pre-existing lien claimant to file a claim against a bankrupt's estate. Inchoate liens were established in the manner prescribed by law and claims were only filed by those who sought distribution under Section 64, having to do only with assets available for distribution to unsecured claimants. The Trustees have, in fact, shown cases where the unqualifiedly filing of claims by lienors, in fact, forfeited such liens.

Your petitioner respectfully urges that reargument should be permitted which will clearly establish the fact that prior to March 3, 1933, the date of the passage of Section 77, *Missouri* vs. *Fiske*, 290 U. S. 18, *Ex Parte New York*, 256 U. S. 490, and *Palmer* vs. *Ohio*, 248 U. S. 32,

would have controlled the disposition of this case by reason of the necessity of the service of process in order to make the State a party. The later cases of *Great Northern Insurance Company* vs. *Read*, 322 U. S. 47, and *Ford Motor Co.* vs. *Indiana*, 322 U. S. 459, lend weight to that well-entrenched pre-existing rule.

V.

Your petitioner respectfully shows that Congress, in the light of its historic policy, could never have intended that a State should be a "creditor" under Section 77 of the Bankruptcy Act.

This Court has said in its opinion:

> "We find not the slightest suggestion that Congress left out the large class of tax claims which recurringly appears in reorganizations and often assumes, as here, large proportions."

Your petitioner respectfully submits that this is not the test. The test is not whether Congress intended to exclude but whether Congress specifically intended to include. Your petitioner is of the earnest belief that upon a reargument it will be able conclusively to show that Congress never intended that a State should be a "creditor" under the said Section 77. The mere multiplicity of tax claims which must arise in railroad reorganizations, as pointed out by this Court, and the failure in this very lengthy act to mention the word "taxes" even once should of itself be dispositive of the question. Your petitioner is deeply puzzled why, for the first time in 14 years, notwithstanding such multiplicity of tax claims, it should now become so apparent that the rule is as stated by this Court and Sec-

tion 77 so clearly applies. During the past 14 years it has always been found necessary to try to read into Section 77 either Section 64 or 57 or 67 if taxes were involved.

Your petitioner freely admits that if prior to March 3, 1933, the rule had been that a State could be required to come into any ordinary bankruptcy proceedings regardless of its consent and notwithstanding it had pre-existing tax liens, we must find in Section 77 words that would change such rule. But the Trustees have shown no authority whatsoever in the law to support any such rule. Your petitioner submits, therefore, that there must be found within Section 77 the authority for the rule now stated by this Court.

What was the intent of Congress? For such intent we must not look to the circumstances of the present cause but to the circumstances and conditions at the time of the passage of Section 77 on March 3, 1933 (47 Stat., ch. 204). The word "taxes" was not used once in that lengthy statute. The said statute provided:

> "If the United States of America is directly a creditor or stockholder, the Secretary of the Treasury is hereby authorized to accept or reject a plan in respect of the interests or claims of the United States."

Your petitioner respectfully shows that in the preceding year the Reconstruction Finance Corporation was created with authority to make loans to railroad companies. The Government had gone into the lending business and was truly a creditor.

Your petitioner submits that the said Section 77 must be read in the light of the troublesome conditions of the time. No one can forget the years just prior to and just subsequent to the year 1933. Thousands upon thousands of "little men" lost everything they had, their businesses, their homes, their hopes. But they didn't lose their obligation to pay any taxes for which they had been personally

liable. By Section 17 (11 U. S. C. A. Section 35) taxes were not dischargeable in bankruptcy. Your petitioner respectfully inquires whether it can be said that Congress in 1933 was so mindful of the corporation as to provide that the taxing authorities should be such creditors as could be wiped out in a reorganization scheme while requiring that these "little men" should still bear the cross of their defaulted unpaid taxes? Congress gave its answer to this question in no uncertain terms when by Section 77(l) it put a railroad in reorganization in the same position as the "little man" who had filed his petition in bankruptcy. Clearly it was intended that taxes should not be dischargeable in either case.

If anything more were needed, it was supplied by Section 77(B), wherein it was specifically provided that Section 64, the only section wherein there is given the authority to review the amount and validity of taxes, was not applicable so long as the Section 77(B) proceedings were reorganization proceedings. The said Section 64 only applied in case of liquidation. Congress did not provide for liquidation under Section 77.

Your petitioner respectfully submits that Congress intended all state taxes to be paid by any corporation in reorganization. If a corporation was not able to discharge such public liabilities, it was not a fit subject of a reorganization.

On August 27, 1935 (49 Stat. 911, ch. 774) the said Section 77 was amended to change the above provision with respect to the Reconstruction Finance Corporation. But again no mention was made of taxes, notwithstanding that the act had now been operating for two years and there was the above mentioned multiplicity of tax claims.

On June 26, 1936 (49 Stat. 1967, ch. 833) the said Section 77 was for the first time amended so as to include taxes and customs' duties due to the United States. Your petitioner believes that the failure of Congress to mention taxes due to a State and its political subdivisions, when after three years of operation the question of taxes was particularly in mind, is of the deepest significance.

Your petitioner respectfully points out that in *Railroad Commission* vs. *Pullman Co.*, 312 U. S. 496, this Court at page 500 called attention to the "scrupulous regard for the rightful independence of the state governments" and spoke further of the "harmonious relation between state and federal authority." In *Chicago* vs. *Fieldcrest Dairies*, 316 U. S. 168, this Court said at page 173:

> "For we are here concerned with the much larger issue as to the appropriate relationship between federal and state authorities functioning as a harmonious whole."

To the same effect are *Spector Motor Service* vs. *McLaughlin*, 232 U. S. 101, and *Thompson* vs. *Magnolia Petroleum Co.*, 309 U. S. 478. Your petitioner believes that this Court was not intending to be expansively gracious when it made the above ruling but that this Court was asserting a definite and salutary principle of law. Your petitioner urges that Congress was no less mindful of that nice relationship that should exist between local taxing authorities and the Federal Government when it enacted legislation with respect to railroad and other corporate reorganizations. The whole history of bankruptcy proves that Congress has been ever mindful of the duty it owed the States and local taxing authorities, and that, just as this Court did in *Palmer* vs. *Massachusetts*, 308 U. S. 79, 83, Congress has recognized the need of a nice balance between national and State authority in this "sensitive area of government."

Your petitioner respectfully shows the following that should disclose the true attitude of Congress. 1.) Congress has always made taxes non-dischargeable. 2.) Congress has given taxes a priority in the distribution of general assets under Section 64, where otherwise such taxes would only share ratably with other general creditors. 3.) Con-

gress has provided by act of January 8, 1934 (28 U. S. C. A. Section 124a) that a Trustee in bankruptcy conducting a business "shall be subject to all State and local taxes applicable to such business, the same as if such business were conducted by an individual or corporation." 4.) Congress specifically limited the application of Section 64, in 77B proceedings to cases of liquidation.

Your petitioner submits that all of the above, together with the well established rule of law at the time of the passage of the said Section 77, to the effect that taxes were not debts and that a debtor-creditor relationship did not arise by reason of the obligation to pay taxes, must lead to the conclusion that Congress never intended that a State having a pre-existing tax lien should be a creditor in a railroad reorganization proceedings.

Your petitioner submits that Section 57(n) does not in any wise change what has been said above. The said section was passed in order to eliminate the necessity of bar orders. The said section is only applicable in cases where elsewhere in the Bankruptcy Act there is a requirement that a claim be filed.

Your petitioner respectfully submits that a reargument will show that every rule of logic, every principle of consistency and probability, must lead to the inescapable conclusion that Congress did not intend that a State having pre-existing liens for taxes should be a creditor under Section 77 of the Bankruptcy Act.

VI.

Your petitioner respectfully submits that this Court has not disposed of the constitutional questions raised by the petitioner in the light of the law as it actually existed at the time of the passage of the said Section 77.

This Court said in its opinion "in the present circumstances there is no collision between § 77 and the Constitution." Your petitioner has admitted that, if this Court properly stated the law as it existed prior to 1933 the issue of constitutionality would have been disposed of. Your petitioner respectfully submits that it has shown that such was not the law, and that on the contrary that the law was clear that, with respect to any vested interest existing at the time of bankruptcy, it was necessary to issue process before jurisdiction could be obtained over any lienor, notwithstanding that the Bankruptcy Court or its agent had possession of the property in question.

Your petitioner has advanced the constitutional question with respect to the right of Congress to compel a State to be a party to any proceedings without its consent. Your petitioner respectfully requests the opportunity to reargue the question of the "collision between Section 77 and the Constitution" in the light of the law as it actually existed on the date of the passage of the said Section 77.

VII.

Your petitioner respectfully submits that the effect to be given the actions of the State fiscal officers must be viewed in the light of the true state of the law.

All of the above has been directed either to the law as it existed prior to the passage of Section 77 or to the intent and power of Congress at the time of such passage. If, directing our attention to such times, it should be finally determined that a State having pre-existing liens for taxes

can be compelled to be a party to Section 77 reorganization proceedings or forfeit its rights in and to liened property, then clearly the State fiscal officers had power to file the proofs of claim in order to protect the State's interests. The State in such an event would not be an "actor" but would be a party to the proceedings by compulsion. Your petitioner respectfully submits that it is no answer to say that the State might stay out, if it saw fit, and forfeit the great sum of money due it.

Your petitioner respectfully submits that it only becomes necessary to determine whether the State is an "actor" if it should be determined that Congress did intend to include a State as a creditor in Section 77 proceedings and that, in order to make the act constitutional, it is necessary to read consent into the said section. Your petitioner therefore respectfully submits that, if it becomes necessary to consider the power of the State fiscal officers to file the said proofs of claim, the consideration of such power must be made in the light of the true state of the law.

Your petitioner respectfully calls to the attention of this Court that it has reversed the Bankruptcy Court with respect to its power to redetermine the amount and validity of the taxes due to the State. It is respectfully submitted that the Bankruptcy Court's claimed power under Section 64 might have had a controlling influence in leading the said Court to its conclusion that the State fiscal officers had the power to file the said proofs of claim. For such reason alone this case should be recalled for the purpose of sending it back to the Bankruptcy Court with the proper instructions.

Your petitioner is of the belief that, if it should be finally determined that a State may not be made a party without its consent and the issue becomes one of consent, an altogether different question will be presented to the Bankruptcy Court with respect to the existence of authority of State officials to bring the State into reorganization pro-

ceedings. It is respectfully submitted that a reargument should be had with respect to the power of the State fiscal officers to bind the State in the event that the State may not be made a party to a Section 77 proceedings without its consent or in the event that the action of the said officers played any substantial part in this Court's determination.

WHEREFORE, Your petitioner prays that this Honorable Court may grant to the State of New Jersey a rehearing in the above entitled cause and your petitioner further prays that this Honorable Court may grant leave to the said State to file a supplemental memorandum with respect to the *Van Huffel* vs. *Harkelrode* case and concerning the intent of Congress with respect to the inclusion of a State with pre-existing liens as a creditor in Section 77 proceedings.

STATE OF NEW JERSEY,

By WALTER D. VAN RIPER,
Attorney-General,

BENJAMIN C. VAN TINE,
Deputy Attorney-General,
Attorneys for Respondent,
State House, Trenton, N. J.

Dated: February 10, 1947.

CERTIFICATE OF COUNSEL.

I, BENJAMIN C. VAN TINE, Deputy Attorney-General, attorney for the State of New Jersey, do hereby certify that the foregoing petition is filed in good faith and not for delay.

BENJAMIN C. VAN TINE.

Dated: February 10, 1947.

SUPREME COURT OF THE UNITED STATES

No. 92.—October Term, 1946.

Walter P. Gardner, Trustee of the Central Railroad Company of New Jersey, Petitioner, *v.* The State of New Jersey.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit.

[January 20, 1947.]

Mr. Justice Douglas delivered the opinion of the Court.

This case, here on certiorari, presents important problems under § 77 of the Bankruptcy Act. 49 Stat. 911, 11 U. S. C. § 205. The Central Railroad Company of New Jersey (the debtor), of which petitioner is trustee, filed its petition for reorganization in 1939 shortly after receiving notice from the Attorney General of New Jersey that he would apply to a state court for a summary judgment for unpaid taxes of the debtor and seek to sell its property in satisfaction of the judgment. The tax assessments for the years 1932 to 1939 had been extensively litigated both in the state and federal courts and the results were for the most part adverse to the debtor.[1] By the end of 1939 the tax claims of the State against the debtor, exclusive of interest and penalties, exceeded $15,000,000, while the liquid assets of the debtor available to pay them were apparently less than half that amount. The reorganization court stayed suits to collect the taxes but from time to time entered orders directing the debtor to make specified installment payments on account of the taxes for various years.

In 1941 the New Jersey legislature passed a law designed to lessen the tax burden of railroads in the State. P. L. 1941, chs. 290, 291. This law was implemented and some-

[1] The history of the litigation is reviewed in the opinion of the Circuit Court of Appeals in this case. 152 F. 2d pp. 408–411.

what modified in 1942. P. L. 1942, chs. 169, 241. These acts included changes in the tax rates and provided for installment payments of the full principal amount of unpaid property taxes without interest or penalties, which were due on or before December 1, 1940. The statutory settlement of the claims was conditioned on (1) the execution of installment payment plans and the payment of the first installment, and (2) a waiver of all rights to contest the legality or amount of any assessment made prior to December 1, 1941, together with written consent to the discontinuance and dismissal of all pending suits concerning such assessments. The reorganization court authorized petitioner to settle and compromise the delinquent taxes in accordance with the provisions of these acts. Petitioner undertook to comply with the statutory requirements, filing documents and payments required of a delinquent taxpayer, discontinuing litigation, and consenting to the discontinuance of pending appeals.[2] The state officials—the Attorney General, Treasurer, and Comptroller—did not accept these tenders.[3] Instead, the Attorney General instituted suit to enjoin the Treasurer from carrying out the provisions of the 1941 and 1942 acts. The result was a holding that the acts violated the New Jersey constitution. *Wilentz* v. *Hendrickson*, 135 N. J. Eq. 244, 38 A. (2d) 199.

Meanwhile the reorganization court set a time within which all claims against the debtor should be filed. In compliance therewith the state Comptroller filed on behalf of the State of New Jersey a claim for taxes owing it.[4]

[2] Delinquencies of subsidiary companies of the debtor were also included.

The 1942 Act increased the 1941 franchise tax of the debtor. The waiver authorized by the reorganization court included a waiver of the right to contest the legality of that additional assessment.

[3] See *In re Central R. Co. of New Jersey*, 136 F. 2d 633, which contains a review of the facts of this episode.

[4] Like claims were also filed against subsidiaries of the debtor.

The proof of claim stated that over $18,000,000 had been paid on the tax claim, leaving unpaid some $12,000,000, plus interest of over $7,700,000, plus additional interest on those sums from December 1, 1940. The proof of claim also stated that under New Jersey law the sums owed were secured by "a lien paramount to all other liens upon all the lands and tangible property and franchises of the company in this State".

The debtor and trustee filed initial objections to the claim. They contended that the property of the debtor was grossly overvalued and that the debtor and other railroads had been intentionally and systematically discriminated against in the making of the assessments. They also objected to the interest or penalty part of the claim, contending, *inter alia*, that no interest accrued after the date when the debtor's petition for reorganization was filed or during the period when collection of the taxes was enjoined and the debtor was in good faith contesting their validity. Subsequently they objected to the claim on the further ground that its amount and the time allowed for its payment were governed by the terms of settlement or compromise tendered under the 1941 and 1942 acts of the New Jersey legislature. They also contended that New Jersey had no lien on the debtor's personal property. Like objections were made by a group of security holders of the debtor and by an indenture trustee. They also objected to the State's claim on the ground that no part of it other than that representing the principal amount of taxes was entitled to a lien equal or paramount to the debtor's general mortgage.

New Jersey, through her Attorney General, filed replies to the various objections which had been made to her claim, stating, *inter alia*, that the principal amount of the claim had been finally adjudicated and was lawfully owing, that the principal amount together with interest was entitled to priority under § 64 of the Bankruptcy Act, and

that the claim was entitled to a paramount lien on all the lands, tangible property, and franchises of the debtor.

Shortly after *Wilentz* v. *Hendrickson, supra,* was decided, the trustee filed with the reorganization court a petition for adjudication of New Jersey's tax claims which in substance recapitulated his earlier objections to the claim and asked for an adjudication that the settlement or compromise tendered under the 1941 and 1942 acts of New Jersey was binding; or alternatively, if it was not binding, a determination of the extent to which the claim should be allowed and the relative rights, liens and priorities of the various claimants in the debtor's assets.

The Attorney General of New Jersey thereupon entered a special appearance in the proceedings, claiming, *inter alia,* that the entertainment of the petition would constitute a prohibited suit against the State, both as respects the determination of the amount of the claim and its priority or lien.

The reorganization court referred New Jersey's claim to a special master to consider this additional contention of the State, as well as the previous objections to it and the State's replies thereto.

The special master rendered a report in 1945 in which he found (1) that the proofs of claim of New Jersey were properly filed by state officers acting in pursuance of their statutory authority; (2) that § 77 confers on the reorganization court jurisdiction over the kind of claims asserted by the State in the proceeding and that such construction of the Act is not unconstitutional; and (3) that the entire property of the debtor is *in custodia legis* subject to the rights of lienholders, and that the reorganization court is the proper court to determine the validity and amount of the tax claims and their lien, subject to the limitations of *Arkansas Corporation Commission* v. *Thompson,* 313 U. S. 132, which he did not think were presently involved in the proceedings. New Jersey, through

her Attorney General, filed objections to the report. The reorganization court overruled them and adopted and confirmed the report. New Jersey took an appeal to the Circuit Court of Appeals. She also filed in that court a petition for a writ of prohibition in which she challenged the rulings of the reorganization court on the same grounds.

The Circuit Court of Appeals treated the appeal as if all of the questions presented were covered by *Arkansas Corporation Commission* v. *Thompson, supra.* It held that the "only matters left open" for the reorganization court were (1) mathematical error in the computation of the amount of the tax or (2) legal error in its assessment. It accordingly reversed the order of the reorganization court and dismissed the application for a writ of prohibition. 152 F. 2d 408, 418.

First. We think, contrary to the position of New Jersey, that the reorganization court had jurisdiction over the proof and allowance of the tax claims and that the exercise of that power was not a suit against the State. Section 77 deals not only with claims of private parties but with those of public agencies as well. Section 77 (b) defines "creditors" as "all holders of claims of whatever character against the debtor or its property, whether or not such claims would otherwise constitute provable claims under this Act". And "claims" are defined to include "debts, whether liquidated or unliquidated, securities (other than stock and option warrants to subscribe to stock), liens, or other interests of whatever character." *Id.* And § 77 (c) (7) provides for the prompt fixing of a reasonable time within which the "claims of creditors" may be filed and the manner in which they may be filed and allowed. The words "all holders of claims" have no qualification and are sufficiently broad to include public agencies as well as private parties. The "claims" of creditors include secured and unsecured claims. We find not

the slightest suggestion that Congress left out the large class of tax claims which recurringly appears in reorganizations and often assumes, as here, large proportions. They are expressly included among provable claims in § 57n of the Bankruptcy Act, 52 Stat. 840, 867, 11 U. S. C. § 93 (n).[5] And the sweeping, all inclusive definitions of "claims" and "creditors" in § 77 leave room for no exception under it.

When a State files a proof of claim in the reorganization court, it is using a traditional method of collecting a debt. A proof of claim is, of course, *prima facie* evidence of its validity. *Whitney* v. *Dresser*, 200 U. S. 532. But the bankruptcy court whose aid is sought for enforcement of an asserted claim is not bound to treat the tendered proof as conclusive. When objections are made, it is duty bound to pass on them. That process is, indeed, of basic importance in the administration of a bankruptcy estate whether the objective be liquidation or reorganization. Without that sifting process, unmeritorious or excessive claims might dilute the participation of the legitimate claimants.

It is traditional bankruptcy law that he who invokes the aid of the bankruptcy court by offering a proof of claim and demanding its allowance must abide the consequences of that procedure. *Wiswall* v. *Campbell*, 93 U. S. 347, 351. If the claimant is a State, the procedure of proof and allowance is not transmuted into a suit against the State because the court entertains objections to the claim. The State is seeking something from the debtor. No judgment is sought against the State. The whole process of proof, allowance, and distribution is, shortly speaking, an adjudication of interests claimed in a *res*. It is none the less such because the claim is rejected *in toto*, reduced in part, given a priority inferior to that claimed, or satisfied in some way other than payment in cash. When

[5] See H. Rep. No. 1409, 75th Cong., 1st Sess., p. 13; S. Rep. No. 1916, 75th Cong., 3d Sess., pp. 5, 16.

the State becomes the actor and files a claim against the fund, it waives any immunity which it otherwise might have had respecting the adjudication of the claim. See *Clark* v. *Barnard*, 108 U. S. 436, 447–448; *Gunter* v. *Atlantic Coast Line*, 200 U. S. 273, 284–289; *Missouri* v. *Fiske*, 290 U. S. 18, 24–25.

The extent of the constitutional authority of the bankruptcy court in this respect was passed upon in *New York* v. *Irving Trust Co.*, 288 U. S. 329. In that case the Court sustained an order of the bankruptcy court which barred a State's tax claim because not filed within the time fixed for the filing of claims. The Court stated, p. 333, "If a state desires to participate in the assets of a bankrupt, she must submit to appropriate requirements by the controlling power; otherwise, orderly and expeditious proceedings would be impossible and a fundamental purpose of the Bankruptcy Act would be frustrated."

In the present circumstances there is, therefore, no collision between § 77 and the Constitution.

Nor can we conclude that the claim was not properly filed by the State. The state Comptroller, who filed the claim on behalf of the State, is authorized to "institute and direct prosecution . . . for just claims and debts due to the state". N. J. R. S. § 52: 19–10c. And see *id.*, § 52: 19–15. The state Attorney General, who resisted the objections made to the claim, is authorized to "attend generally to all matters in which the state is a party or in which its rights and interests are involved". *Id.*, § 52: 17–2g. The special master, whose report the reorganization court adopted, held that what these officials did in this case was in pursuance of their authority. For that conclusion he relied on the statutes which we have mentioned and the practice in other reorganization proceedings. That construction of New Jersey law made by a federal judge of the New Jersey District Court is entitled to special weight. *Steele* v. *General Mills*, decided January 6, 1947. We find nothing which impeaches it. To hold otherwise

might, indeed, imperil the claim which New Jersey so vigorously asserts. For it appears that the time for filing claims has expired and under the rule of *New York* v. *Irving Trust Co., supra*, a filing at this late date might come too late.[6]

Second. New Jersey contends that Congress did not include a State's tax liens within the scheme of § 77 proceedings. That is but another way of saying that since the State's asserted liens attached before the reorganization petition was filed, the only property of the debtor *in custodia legis* was its equity after the tax liens were satisfied.

We do not agree with that conclusion. We partially answered the contention when we reviewed the broad, all inclusive nature of the definitions of "creditors" and "claims" contained in § 77 (b). As those definitions make plain, "all holders of claims" include those who assert "liens" against the property of the debtor.

Section 77 (b), moreover, gives the reorganization court broad powers over all types of liens. Thus a plan of reorganization "shall include provisions modifying or altering the rights of creditors generally, or of any class of them, secured or unsecured, either through the issuance of new securities of any character or otherwise". § 77 (b) (1).

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[6] See *Meyer* v. *Fleming*, 327 U. S. 161, 169, footnote 18: "Sec. 77 (c) (7) provides that the judge 'shall promptly determine and fix a reasonable time within which the claims of creditors may be filed or evidenced and after which no claim not so filed or evidenced may participate except on order for cause shown . . .' This is the equity rule (5 Collier on Bankruptcy (1944) p. 537) which permits the filing of claims out of time provided the claim is equitable, the claimant is not chargeable with laches, and the assets have not been distributed (see *Conklin* v. *United States Shipbuilding Co.*, 136 F. 1006, 1009–1010; *Pennsylvania Steel Co.* v. *New York City R. Co.*, 198 F. 721, 740–742); and provided further that the late filing does not unduly delay the proceedings. *Guaranty Trust Co.* v. *Henwood*, 86 F. 2d 347, 353."

A plan of reorganization may provide for "the sale of all or any part of the property of the debtor either subject to or free from *any lien* at not less than a fair upset price". § 77 (b) (5). (Italics added.) It may order "the distribution of all or any assets, or the proceeds derived from the sale thereof, among those having an interest therein". *Id.* Or it may provide for "the satisfaction or modification of *any liens*" or "the curing or waiver of defaults". *Id.* (Italics added.) This is comprehensive language suggesting that all liens are included, not that some are beyond the reach of the court. While valid liens existing at the commencement of bankruptcy proceedings have always been preserved, it has long been a function of the bankruptcy court to ascertain their validity and extent and to determine the method of their liquidation. *Whitney* v. *Wenman*, 198 U. S. 539, 552; *Isaacs* v. *Hobbs Tie & Timber Co.*, 282 U. S. 734, 737–738; *Straton* v. *New*, 283 U. S. 318, 321. Moreover, both in receivership cases, *New York* v. *Maclay*, 288 U. S. 290; *United States* v. *Texas*, 314 U. S. 480, and in bankruptcy cases, *Van Huffel* v. *Harkelrode*, 284 U. S. 225; *New York* v. *Irving Trust Co.*, *supra*, the authority of the court to deal with the lien of a State has long been recognized. In reorganization cases the task of resolving disputes as to liens is a common one for the court. See *Institutional Investors* v. *Chicago, St. P. & P. R. Co.*, 318 U. S. 523, 569. Indeed, before a plan of reorganization can be designed in accord with fair and equitable requirements, liens must be disentangled and their relative priorities ascertained. This problem, present in most reorganizations, is acute in the railroad field.

If the reorganization court lacked the power to deal with tax liens of a State, the assertion by a State of a lien would pull out chunks of an estate from the reorganization court and transfer a part of the struggle over the corpus into tax bureaus and other state tribunals. That would not only seriously impair the power of the court to administer

the estate and adversely affect the power of the Interstate Commerce Commission and the court to promulgate a reorganization plan. See *Ecker* v. *Western Pacific R. Corp.*, 318 U. S. 448, 466–475; *Smith* v. *Hoboken Railroad, W. & S. C. Co.*, 328 U. S. 123. It would fly in the teeth of § 77 (a) which grants the reorganization court "exclusive jurisdiction of the debtor and its property wherever located". That jurisdiction is not limited to the prevention of interference with the use of the property by the trustee; it "extends also to the adjudication of questions respecting the title." *Ex parte Baldwin*, 291 U. S. 610, 616; *Thompson* v. *Texas Mexican Ry. Co.*, 328 U. S. 134, 140. It is the exclusive jurisdiction of the reorganization court which gives it power to preserve the railway as a unit and as a going concern and to prevent it from being divided up and dismembered piece-meal. Only in that way can continuous operation of the road be assured and a plan of reorganization be effected which not only safeguards the interests of the various claimants but is also compatible with the public interest. *Continental Bank* v. *Rock Island Ry. Co.*, 294 U. S. 648; *Smith* v. *Hoboken Railroad, W. & S. C. Co.*, *supra*.

When § 77 is read against this historical background and in light of practical requirements, we cannot conceive that Congress gave the reorganization court power less replete than the sweeping language of § 77 suggests.

The constitutional authority of Congress to grant the bankruptcy court power to deal with the lien of a State has been settled. In *Van Huffel* v. *Harkelrode*, *supra*, the Court held that the bankruptcy court was constitutionally empowered to order a sale of property of a bankrupt free and clear of a lien of a State for taxes.

We hold that the reorganization court has jurisdiction over all of the property of the debtor including that on which New Jersey asserts a lien and that the power of the

court to deal with liens extends to the lien which New Jersey claims.[7]

Third. We held in *Arkansas Corporation Commission* v. *Thompson, supra,* that the reorganization court lacked the power under § 77 to redetermine for state tax purposes the property value of a railroad where that value had already been determined in state proceedings which afforded ample protection to the railroad's rights. We adhere to that decision. Its ruling precludes redetermination by the reorganization court in this case of the valuations underlying the assessments made by the state authorities and the validity of those assessments used as the basis for the computation of the taxes. It may not therefore entertain the objections to New Jersey's claim which tender those issues. The proper tribunals where those issues may be litigated, if they are still open for any year, are the state agencies and courts and, under special circumstances, the federal courts. *Hillsborough* v. *Cromwell,* 326 U. S. 620. The Circuit Court of Appeals has reviewed at length the New Jersey procedure available for challenging the valuations which underly assessments. 152 F. 2d pp. 411–414. By the standards of *Arkansas Corporation Commission* v. *Thompson, supra,* that procedure is adequate, so that relitigation of the question in the reorganization proceedings would not be appropriate.

Fourth. The rule of *Arkansas Corporation Commission* v. *Thompson, supra,* does not, however, preclude the reorganization court from adjudicating the other issues raised

[7] Section 64a of the Bankruptcy Act determines the priority to which taxes owing a State are entitled and grants the bankruptcy court power to determine questions concerning "the amount or legality of any taxes". In *Arkansas Corporation Commission* v. *Thompson, supra,* we reserved decision on whether § 64a was applicable in reorganizations under § 77. We do not reach that question here. For § 77 alone is adequate to sustain the asserted jurisdiction of the reorganization court over all the property of the debtor. See *Lyford* v. *City of New York,* 137 F. 2d 782, 785–786.

by the objections to New Jersey's claim. The contrary view, which the Circuit Court of Appeals apparently took, fails to recognize historic bankruptcy powers which, as we have already pointed out,[8] are part of the arsenal of authority granted the reorganization court by § 77.

(1) The validity and priority of one lien, whether or not claimed by a State, as against other liens, are questions for the reorganization court. Illustrating but not limiting the range of that inquiry are questions whether local law creates the lien asserted; whether it was sufficiently perfected prior to the petition for reorganization as to be good against other liens, *cf. New York* v. *Maclay, supra; United States* v. *Texas, supra;* whether, if it were inchoate at that time, it could be perfected subsequent to the petition, *Lyford* v. *State of New York*, 140 F. 2d 840; and whether the lien, though paramount, is subordinate to administration expenses or other claims under either the general bankruptcy rule, *City of New York* v. *Hall*, 139 F. 2d 935, or the equity rule,[9] 5 Collier on Bankruptcy (14th ed.) ¶ 77.21. See *Warren* v. *Palmer*, 310 U. S. 132.

(2) The extent of the lien—to what property it applies, and whether it is restricted to realty or covers personal property or revenues as well—are also questions for the reorganization court. See *Ecker* v. *Western Pacific R. Corp., supra*, pp. 489, 503.

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[8] As stated in *Isaacs* v. *Hobbs Tie & Timber Co., supra*, p. 738, "while valid liens existing at the time of the commencement of a bankruptcy proceeding are preserved, it is solely within the power of a court of bankruptcy to ascertain their validity and amount and to decree the method of their liquidation."

[9] Section 77 (a) provides that if the petition is approved the reorganization court "during the pendency of the proceedings under this section and for the purposes thereof, . . . shall have and may exercise in addition to the powers conferred by this section all the powers, not inconsistent with this section, which a Federal court would have had if it had appoin[illegible] a receiver in equity of the property of the debtor for any purpose."

(3) The reorganization court may also adjudicate questions pertaining to the amount of a tax claim secured by a lien without crossing the forbidden line marked by *Arkansas Corporation Commission* v. *Thompson, supra.* There is, for example, the question whether the amount of the claim has been swollen by the inclusion of a forbidden penalty and thus to that extent does not meet the bankruptcy requirements for proof and allowance of claims. Section 57j of the Bankruptcy Act provides that debts owing a State as a "penalty or forfeiture" [10] shall not be allowed. What claims accruing before bankruptcy and sought to be proved by a State are "penalties", *New York* v. *Jersawit*, 263 U. S. 493, and what are not, *Meilink* v. *Unemployment Reserves Commission*, 314 U. S. 564; the applicability of § 57j to reorganizations under § 77; [11] the liability of the estate for penalties incurred by the trustee in the operation of the business *Boteler* v. *Ingels*, 308 U. S. 57; what interest, if any, accrues after the petition for reorganization has been filed, *Vanston* v. *Green*, 329 U. S. —, are all questions for the reorganization court.

(4) We noted in *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106, 130, that one useful and fitting function of a reorganization court was the compromise or settlement of claims, so that interminable litigation might be

[10] Section 57j reads in full:

"Debts owing to the United States or any State or subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law."

[11] Section 77 (l) provides:

"In proceedings under this section and consistent with the provisions thereof, the jurisdiction and powers of the court, the duties of the debtor and the rights and liabilities of creditors, and of all persons with respect to the debtor and its property, shall be the same as if a voluntary petition for adjudication had been filed and a decree of adjudication had been entered on the day when the debtor's petition was filed."

ended and the interests of expedition in promulgating a plan of reorganization served. That power, expressly included in the Bankruptcy Act [12] and governed by our General Order No. 33 [13] is part of the broad authority granted the reorganization court by § 77.[14] Through the appropriate exercise of that power, the court may authorize the trustee to compromise claims, secured or unsecured, and may approve equitable adjustments of them, and so reduce or otherwise affect the participation that the claimant, whether a State or another, may have in the *res* which is *in custodia legis.*

It is urged in this case that the settlement and compromise of New Jersey's tax claim which the reorganization court authorized the trustee to make under the so-called settlement acts of the New Jersey legislature of 1941 and 1942 was an appropriate exercise of that power; that the compromise was valid and binding under New Jersey law; and that even if the compromise was not valid, payments made by the trustee and the conduct of the parties have altered the claim as respects the lien, the principal amount of the claim, and the interest or penalty portion of it. New Jersey vigorously contests all and each of these contentions.

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[12] Section 27 provides:

"The receiver or trustee may, with the approval of the court, compromise any controversy arising in the administration of the estate upon such terms as he may deem for the best interest of the estate."

[13] General Order No. 33 provides:

"Whenever a receiver, trustee or debtor in possession shall make application to the court for authority to submit to arbitration any controversy arising in the settlement of an estate, or for authority to compromise any such controversy, the application shall clearly and distinctly set forth the subject matter of the controversy, and the reasons why it is proper and for the best interest of the estate that the controversy should be settled by arbitration or compromise." 305 U. S. App. 16.

[14] See § 77 (l), note 11, *supra*, and § 77 (a), note 9, *supra*.

A phase of this controversy was before the Circuit Court of Appeals in *In re Central R. Co. of New Jersey, supra.* That court had before it on appeal the order of the reorganization court (entered prior to the decision in *Wilentz* v. *Hendrickson, supra,* holding the acts of 1941 and 1942 unconstitutional) which, on the basis of the compromise, allowed New Jersey's claim only in a reduced amount. The Circuit Court of Appeals held (1) that it would have been more appropriate for the reorganization court to have stayed its hand pending determination of the state litigation and (2) that in any event, it should not have passed on the constitutionality of the 1941 and 1942 acts without giving New Jersey an opportunity for a hearing and argument on the issue. This controversy is now in a different posture. New questions of local law emerge—whether *Wilentz* v. *Hendrickson, supra,* controls this case; whether a valid settlement can be made under an unconstitutional act and, if so, whether this alleged compromise was valid and effective; whether, if the settlement was not binding, the amount of the claim or the extent of the lien has been altered by the payments made during reorganization or by the conduct of the parties.

These points have been briefed and argued here. The difficulty is that neither the reorganization court nor the Circuit Court of Appeals passed on them. The reorganization court passed solely on a question of jurisdiction—whether it had the power to make adjudications concerning the amount of New Jersey's claim which should be allowed and the validity and extent of her lien, or whether New Jersey's sovereign immunity stood in the way of such determinations. And the Circuit Court of Appeals did not pass on these questions because it, too, was concerned solely with the question of jurisdiction.

These issues bristle with questions of New Jersey law on which we should not pass, even if we were to assume they are properly here, without the benefit of the views of

judges who sit there and have a greater familiarity with local law and local practices than we. See *Huddleston* v. *Dwyer*, 322 U. S. 232, 237; *Brillhart* v. *Excess Insurance Co.*, 316 U. S. 491, 497; *Hammond* v. *Schappi Bus Line*, 275 U. S. 164, 169; *Wilson Cypress Co.* v. *Del Pozo*, 236 U. S. 635, 656–657. And for a review of the earlier cases, see dissenting opinion of Mr. Justice Brandeis in *Railroad Commission* v. *Los Angeles R. Co.*, 280 U. S. 145, 164–165. Moreover, we are now advised that there is presently pending before the Circuit Court of Appeals an appeal by the Attorney General of New Jersey from an order of the reorganization court denying leave to join the trustee as party defendant in a suit in the New Jersey courts to determine whether there was a valid settlement of the tax claims and to stay further determination of that controversy in the federal court until the state courts have passed on the question.[15] If the Circuit Court of Appeals orders the application granted, cf. *Thompson* v. *Magnolia Petroleum Co.*, 309 U. S. 478, 483; *Ex parte Baldwin*, *supra*, p. 619, the state law phases of the controversy will be authoritatively settled. If the other course is followed, the issues can be resolved by the reorganization court on a record more adequate than the present one for purposes of review. Whatever procedure is followed it is more fitting that those more versed than we in the intricacies and niceties of New Jersey law first pass on these questions.

We intimate no opinion on the merits of the settlement controversy. Nor do we intimate any view on the amount of the tax claim which should be allowed or on the validity, character, priority, or extent of the lien asserted by New Jersey, or on the manner in which it should be satisfied in a plan for reorganization. We only hold that the reor-

[15] *New Jersey et al.* v. *Central Railroad Co. of New Jersey*, No. 8808. We are advised that by stipulation of the parties the case is being held in the Circuit Court of Appeals until the jurisdictional question involved in the instant case has been decided.

ganization court could properly entertain all objections to the claim except those involving the valuations underlying the assessments and the validity of those assessments.

On the present record we do not know all the issues that were involved in the prolonged litigation concerning the taxes for the years in question. Hence, what we have said is subject to the limitation that *res judicata* may have made binding on the reorganization court various questions of local law, including the amount and validity of the taxes under New Jersey law and the character and extent of the lien which that law affords them.

We affirm in part and reverse in part the judgment of the Circuit Court of Appeals and remand the cause to the District Court for further proceedings in conformity with this opinion.

So ordered.